

File No. PCAOB-2022-01
Consists of 1607 Pages

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 19b-4

Proposed Rules

By

Public Company Accounting Oversight Board

In accordance with Rule 19b-4 under the
Securities Exchange Act of 1934

1. Text of the Proposed Rules

(a) Pursuant to the provisions of Section 107(b) of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley" or the "Act"), the Public Company Accounting Oversight Board (the "Board" or the "PCAOB") is filing with the Securities and Exchange Commission ("SEC" or "Commission") proposed amendments to its auditing standards to strengthen the requirements and responsibilities that apply to auditors who plan and perform audits that involve other accounting firms and individual accountants (collectively, the "proposed rules"). The proposed rules changes are attached as Exhibit A to this filing. In addition, the Board is also requesting the SEC's approval, pursuant to Section 103(a)(3)(c) of the Act, of the application of the proposed rules to audits of emerging growth companies ("EGCs"), as that term is defined in Section 3(a)(80) of the Securities Exchange Act of 1934. Section 104 of the Jumpstart Our Business Startups Act provides that any additional rules adopted by the Board subsequent to April 5, 2012 do not apply to the audits of EGSs 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." *See Exhibit 3.*

(b) The proposed rule changes will supersede AS 1205, *Part of the Audit Performed by Other Independent Auditors*.

(c) Not applicable.

2. Procedures of the Board

(a) The Board approved the proposed rules, and authorized them for filing with the SEC, at its open meeting on June 21, 2022. No other action by the Board is necessary for the filing of the proposed rules.

(b) Questions regarding this rule filing may be directed to Barbara Vanich, PCAOB Acting Chief Auditor, Office of the Chief Auditor (202/207-9363, vanichb@pcaobus.org); Dima Andriyenko, Acting Deputy Chief Auditor (202/207-9130, andriyenkod@pcaobus.org); Stephanie Hunter, Assistant Chief Auditor (202/591-4408, hunters@pcaobus.org); Andrew Cleve, Assistant Chief Auditor (646/437-5271, clevea@pcaobus.org); Hunter Jones, Chief Counsel, Office of the Chief Auditor (202/591-4412, jonesh@pcaobus.org); Michael Gurbutt, Acting Director, Office of Economic and Risk Analysis (202/591-4739, gurbuttm@pcaobus.org); Tian Liang, Associate Director, Economic Analysis (202/591-4356, liangt@pcaobus.org); John Powers, Assistant Director, Economic Analysis (202/591-4273, powersj@pcaobus.org); and Vincent Meehan, Associate General Counsel, Office of the General Counsel (202/251-0073, meehanv@pcaobus.org).

3. Board's Statement of the Purpose of, and the Statutory Basis for, the Proposed Rules Change

(a) Purpose

The Board has amended its auditing standards to strengthen requirements for planning and supervising audits involving accounting firms and individual accountants (collectively, "other auditors") outside the accounting firm that issues the auditor's report (the "lead auditor"). In these audits, the lead auditor issues the audit report on the

company's consolidated financial statements, but other auditors often perform important work on the audit. Working with other auditors and referred-to 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 their work and can reduce audit quality. 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 audit report.

This rulemaking is intended to increase and improve the lead auditor's involvement in and evaluation of the other auditors' work. The Board believes that the heightened attention to other auditors' work will improve communication among auditors and the lead auditor's ability to prevent or detect deficiencies in that work, and thus enhance the quality of audits involving other auditors and promote investor protection.

The amendments to the Board's auditing standards are intended to improve PCAOB standards principally by applying a risk-based supervisory approach to the lead auditor's oversight of other auditors and requiring that the lead auditor perform certain procedures when planning and supervising an audit that involves other auditors. The amendments take into account recent practice developments in the lead auditor's oversight of other auditors' work, including the greater use of communication technology.

See Exhibit 3 for additional discussion of the purpose of this project.

(b) Statutory Basis

The statutory basis for the proposed rules is Title I of the Act.

4. Board's Statement on Burden on Competition

Not applicable. The Board's consideration of the economic impacts of the standard and amendments are discussed in Exhibit 1.

5. Board's Statement on Comments on the Proposed Rules Change Received from Members, Participants or Others

The Board initially released the proposed rules for public comment on April 12, 2016. *See* Exhibit 2(a)(A). The Board also issued two supplemental requests for comment on September 26, 2017 and on September 28, 2021. *See* Exhibits 2(a)(B) and 2(a)(C). The Board received 64 written comment letters relating to its initial proposed rules. *See* Exhibit 2(a)(D). The Board's Standing Advisory Group ("SAG") also discussed the proposed rules at meetings on May 18, 2016, December 1, 2016, May 24, 2017, and November 30, 2017. *See* Exhibit 2(a)(E).

6. Extension of Time Period for Commission Action

The Board does not consent to an extension of the time period specified in Section 19(b)(2) of the Securities Exchange Act of 1934.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rules Based on Rules of Another Board or of the Commission

Not applicable.

9. Exhibits

- Exhibit A - Text of the Proposed Rules.
- Exhibit 1 - Form of Notice of Proposed Rules for Publication in the *Federal Register*
- Exhibit 2(a)(A) - PCAOB Release No. 2016-002 (Apr. 12, 2016) ("Proposed Release")
- Exhibit 2(a)(B) - PCAOB Release No. 2017-005 (Sept. 26, 2017) ("2017 SRC")
- Exhibit 2(a)(C) - PCAOB Release No. 2021-005 (Sept. 28, 2021) ("2021 SRC")
- Exhibit 2(a)(D) - Alphabetical List of Comments and Written Comments on the Proposed Release, 2017 SRC, and 2021 SRC
- Exhibit 2(a)(E) - Transcripts From Relevant SAG Meetings
- Exhibit 3 - PCAOB Release No. 2022-002 (Adopting Release)

10. Signatures

Pursuant to the requirements of the Act and the Securities Exchange Act of 1934, as amended, the Board has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Public Company Accounting Oversight Board

By: 

Phoebe W. Brown
Secretary

June 24, 2022

EXHIBIT A – TEXT OF THE PROPOSED RULES**AMENDMENTS TO PCAOB AUDITING STANDARDS RELATING TO THE PLANNING AND SUPERVISION OF AUDITS INVOLVING OTHER AUDITORS**

The Board has adopted amendments to certain PCAOB auditing standards related to the planning and supervision of audits involving other auditors. The table below is a reference tool for the amendments.

PCAOB Standard	Title	Paragraphs Amended
AS 1015	Due Professional Care in the Performance of Work	.01, .06
AS 1105	Audit Evidence	.B1, .B2
AS 1201	Supervision of the Audit Engagement	.01, .03–.05, .07–.15 (new), .A1, .A2 (deleted)
AS 1215	Audit Documentation	.03, .18, .19
AS 1220	Engagement Quality Review	.02, .10
AS 2101	Audit Planning	.03, .04, .06, .06A–.06I (new), .07, .09–.11, heading after .13 (new), .14, .16, .A1, .A3–.A6 (new)

Note: The amended paragraphs referenced above include revisions to the accompanying footnotes.

Amendments to AS 1015

I. AS 1015 is amended by adding a note to paragraph .01 to read as follows:

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 meaning as defined in Appendix A of AS 2101.

II. AS 1015 is amended by adding footnote 3 and revising footnote 4 to paragraph .06 to read as follows:

.06 Engagement team³ 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

³ The term "engagement team," as used in this standard, has the same meaning as defined in Appendix A of AS 2101.

4 *See* AS 1201.

Amendments to AS 1105

III. AS 1105 is amended by revising paragraph .B1 to read as follows:

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

IV. AS 1105 is amended by revising paragraph .B2 to read as follows:

.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.

Amendments to AS 1201

V. AS 1201 is amended by adding footnote 1 to paragraph .01 as follows:

.01 This standard establishes requirements regarding supervision of the audit engagement, including supervising the work of engagement team¹ 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*.

VI. AS 1201 is amended by revising paragraph .03 to read as follows:

.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 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}

^{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 meaning as defined in Appendix A of AS 2101.

VII. AS 1201 is amended by revising paragraph .04 to read as follows:

.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.

VIII. AS 1201 is amended by revising footnote 9 of paragraph .05 to read as follows:

⁹ See, e.g., AS 2101.15, AS 2110.74, and paragraphs .20–.23 and .35–.36 of AS 2810, *Evaluating Audit Results*.

IX. AS 1201 is amended by adding, after paragraph .06, a new heading and new paragraphs .07–.13:

Procedures to Be Performed by the Lead Auditor with Respect to the Supervision of Work Performed by Other Auditors¹⁴

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 associated with 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. See also requirements in AS 2110.59 regarding the auditor's responsibility to identify and assess the risks of material misstatement at the financial statement level and assertion level.

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 the other auditor 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 auditor, 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.

- X.** AS 1201 is amended by adding, after new paragraph .13, a new heading and new paragraphs .14–.15:

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.

XI. AS 1201, Appendix A, is amended to read, in its entirety, as follows:

Appendix A – Definitions

.A1 For purposes of this standard:

- a. The term "engagement partner" 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*.

Amendments to AS 1215

XII. AS 1215 is amended by adding footnote 1A to paragraph .03 to read as follows:

.03 Audit documentation is reviewed by members of the engagement team^{1A} performing the work and might be reviewed by others. Reviewers might include, for example:

^{1A} The term "engagement team," as used in this standard for audit engagements, has the same meaning as defined in Appendix A of AS 2101, *Audit Planning*. As used in this

standard for review and attestation engagements, the term has a meaning analogous to the term's definition in AS 2101 for audit engagements.

XIII. AS 1215 is amended by revising paragraph .18 to read as follows:

.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 auditor," as used in this standard, has the same meaning as defined in Appendix A of AS 2101.

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. Compliance with this standard does not substitute for compliance with Section 106(b) or any other applicable law.

XIV. AS 1215 is amended by revising paragraph .19 to read as follows:

.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 offices of the firm and 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 other 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.

^{4A} For multi-tiered audits, *see* note to paragraph .14 of AS 1201, *Supervision of the Audit Engagement*.

Amendments to AS 1220

XV. AS 1220 is amended by adding footnote 1A to paragraph .02 to read as follows:

.02 The objective of the engagement quality reviewer is to perform an evaluation of the significant judgments made by the engagement team^{1A} and the related conclusions reached in forming the overall conclusion on the engagement and in preparing the engagement report, if a report is to be issued, in order to determine whether to provide concurring approval of issuance.¹

^{1A} The term "engagement team," as used in this standard for audit engagements, has the same meaning as defined in Appendix A of AS 2101, *Audit Planning*. As used in this standard for review and attestation engagements, the term has a meaning analogous to the term's definition in AS 2101 for audit engagements.

XVI. AS 1220 is amended by adding a bullet at the end of paragraph .10a to read as follows:

.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,
- 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 meaning as defined in Appendix A of AS 2101. AS 2101.06A–.06C 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.

Amendments to AS 2101

XVII. AS 2101 is amended by setting the term "engagement team" in boldface type in paragraph .03 and revising paragraph .03 to read as follows:

.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.

XVIII. AS 2101 is amended by revising paragraph .04 to read as follows:

.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 auditors** or **referred-to auditors**, 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).

XIX. AS 2101 is amended by revising paragraph .06b to read as follows:

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

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.

^{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–.06F 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.

XX. AS 2101 is amended by adding, after paragraph .06, a new heading:

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

XXI. AS 2101 is amended by adding new subheadings and new paragraphs .06A–.06I:

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. *See also* AS 1201.07, which states that for engagements that involve other auditors, AS 1201.08–.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 AS 1201.

.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 or description, 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) of 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.

XXII. AS 2101 is amended by revising footnote 6 to paragraph .07 to read as follows:

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)(B) and 7201(3)(B).

XXIII. AS 2101 is amended by revising footnotes 8, 9, and 10 to paragraph .09 to read as follows:

⁸ *See, e.g.*, 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 how to determine 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 *See* paragraphs .06–.06I of this standard.

¹⁰ *See, e.g.*, AS 1015.06, paragraph .16 of this standard, and AS 2301.05a.

XXIV. AS 2101 is amended by revising footnote 12 to paragraph .10 to read as follows:

¹² AS 2301 and AS 2201.

XXV. AS 2101 is amended by deleting footnote 13 to paragraph .11, which will read as follows:

^[13] [Footnote deleted.]

XXVI. AS 2101 is amended by adding a new heading after paragraph .13 to read as follows:

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

XXVII. AS 2101 is amended by revising paragraph .14, including the deletion of footnote 18, to read as follows:

.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.

^[18] [Footnote deleted.]

XXVIII. AS 2101 is amended by revising paragraph .16 to read as follows:

.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.

XXIX. AS 2101, Appendix A, is amended by revising the title to read as follows:

Appendix A – Definitions

XXX. AS 2101, Appendix A, is amended by revising paragraph .A1 to read as follows:

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

XXXI. AS 2101, Appendix A, is amended by adding, after paragraph .A2, new paragraphs .A3–.A6:

.A3 Engagement team –

a. Engagement team includes:

- (1) Partners, principals, and shareholders of, and accountants¹ 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, in connection with the audit, (i) are employed by the lead auditor or an other auditor participating in the audit and (ii) assist that auditor 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) of 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 firm³ 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 secondees⁵ 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) of 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 an individual participating in a secondment arrangement in which, for at least three consecutive months, (1) a professional employee of an accounting firm in one country works for a registered public accounting firm that is located in another country and is issuing an auditor's report, and (2) the professional employee performs audit procedures with respect to entities and their operations in that other country and

does not perform more than de minimis audit procedures in relation to entities or business operations in the country of his or her employer. A secondee can be either physically located in that other country or working through a remote work arrangement.

.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 units⁶ 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.

ADOPTION OF NEW AUDITING STANDARD AS 1206

The Board has adopted new auditing standard AS 1206. The text of this standard is set forth below.

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

Introduction

.01 This standard establishes requirements for the lead auditor¹ regarding dividing responsibility for the audit of the company's financial statements² and, if applicable, internal control over financial reporting³ with a referred-to auditor.⁴

¹ The term "lead auditor," as used in this standard, has the same meaning as defined in Appendix A 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–.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.

⁴ The term "referred-to auditor," as used in this standard, has the same meaning as defined in Appendix A of AS 2101.

Note: AS 2101 establishes requirements regarding serving as the lead auditor.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–.09 of this standard in relation to each of the referred-to auditors 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.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

⁵ See paragraphs .06A–.06C of AS 2101.

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

with the referred-to auditor, to test and evaluate the consolidation or combination of the financial statements of the business units⁷ audited by the referred-to auditor into the company's financial statements.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 Securities and Exchange Commission ("SEC"); and
- 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 the audit and issued

⁷ The term "business units" includes subsidiaries, divisions, branches, components, or investments.

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.

the auditor's report in accordance with the standards of the PCAOB,⁹

- b. The lead auditor determines, based on inquiries made of the referred-to auditor and other information obtained by the lead auditor during the audit, that the referred-to auditor 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 is registered with the PCAOB if (1) it played a substantial role in the preparation or furnishing of the lead auditor's report or (2) the referred-to auditor's report is with respect to a business unit that is itself an issuer, broker, or dealer;¹⁰ and
- d. In situations when the financial statements of the company's business unit audited by the referred-to auditor are prepared using a financial reporting framework that differs from the financial reporting framework used to prepare the company's

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*, apply to auditors' reports issued 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 applies to auditors' reports issued for audits of management's assessment of the effectiveness of internal control over financial reporting that are 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 (see AS 3101.06 and .09g, and AS 2201.85A and .85Dd) do not apply to a referred-to auditor's report. 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.

¹⁰ See PCAOB Rule 2100, *Registration Requirements for Public Accounting Firms*, and paragraph (p)(ii) of 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."

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) 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 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 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.¹¹

- c. Withdraw from the engagement.

¹¹ 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.

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 (or reports, if the lead auditor chooses to issue separate reports on the company's financial statements and on internal control over financial reporting) should:

- a. Indicate clearly, in the Opinion on the Financial Statements and, if applicable, Internal Control over Financial Reporting 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 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;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, or other appropriate criteria necessary to identify the portion of the company's financial statements audited by the referred-to auditor.

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

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.¹³

.09 If the report of the referred-to auditor includes an opinion other than 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 unqualified opinion and its disposition, or to the explanatory language, or to both, unless the matter is clearly trivial to the company's financial statements.

Appendix A – Definitions

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

Appendix B – Examples of Reporting by the Lead Auditor Indicating the Division of

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 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.

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 Chooses¹⁵ 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

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, 20X2 and 20X1, and the related 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"). We also have audited 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:*

¹⁵ 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.

20XX issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)."].

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. 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 as of December 31, 20X2, based on [*Identify control 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, 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 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.¹⁶

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 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

¹⁶ 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.)

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. 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 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.

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.

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 Statements¹⁷

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 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

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.)

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.¹⁸

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.

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.*)

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 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 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 3: Conversion Adjustments Audited by the Lead Auditor

We did not audit the financial statements of B Company, a wholly-owned subsidiary. The financial statements of B Company prepared under [*financial reporting framework used by B Company*] 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 under [*financial reporting framework used by B Company*], 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, 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. 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 4: Conversion Adjustments Audited by the Referred-to Auditor

We did not audit the financial statements of B Company, a wholly-owned subsidiary. The financial statements of B Company prepared under [*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 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 under accounting principles generally accepted in the United States of America, 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, 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.

OTHER RELATED AMENDMENTS TO PCAOB AUDITING STANDARDS

In connection with the amendments to PCAOB auditing standards adopted by the Board, the Board has adopted conforming amendments to its auditing standards, auditing interpretations, attestation standards, rules, and Form AP. The table below is a reference tool for these conforming amendments.

PCAOB Standard, Auditing Interpretation, Rule, or Form AP	Title	Paragraphs Amended
AS 1205	Part of the Audit Performed by Other Independent Auditors	Rescinded

PCAOB Standard, Auditing Interpretation, Rule, or Form AP	Title	Paragraphs Amended
AS 1210	Using the Work of an Auditor-Engaged Specialist	.03
AS 1301	Communications with Audit Committees	.10e, .15
AS 2110	Identifying and Assessing Risks of Material Misstatement	.05e, .11A (new), .13, .64
AS 2201	An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements	.09, .B23, .C1, .C8, .C9 (deleted), .C10, .C11
AS 2301	The Auditor's Responses to the Risks of Material Misstatement	.05a
AS 2401	Consideration of Fraud in a Financial Statement Audit	.53, .61
AS 2410	Related Parties	.03, subheading before .08, .09, .16

PCAOB Standard, Auditing Interpretation, Rule, or Form AP	Title	Paragraphs Amended
AS 2601	Consideration of an Entity's Use of a Service Organization	.01, .18, .19
AS 2605	Consideration of the Internal Audit Function	.19
AS 2610	Initial Audits-Communications Between Predecessor and Successor Auditors	.12, .16
AS 2710	Other Information in Documents Containing Audited Financial Statements	.04
AS 2810	Evaluating Audit Results	.29
AS 3101	The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion	.12e, .18
AS 3105	Departures from Unqualified Opinions and Other Reporting Circumstances	.55
AS 3305	Special Reports	.31

PCAOB Standard, Auditing Interpretation, Rule, or Form AP	Title	Paragraphs Amended
AS 4105	Reviews of Interim Financial Information	.18b, .39, .40, .52
AS 6115	Reporting on Whether a Previously Reported Material Weakness Continues to Exist	.24, heading before paragraph .40, .40
AI 10	Part of the Audit Performed by Other Independent Auditors: Auditing Interpretations of AS 1205	Rescinded
AI 28	Evidential Matter Relating to Income Tax Accruals: Auditing Interpretations	.12
AT 1	Examination Engagements Regarding Compliance Reports of Brokers and Dealers	.06
AT 2	Review Engagements Regarding Exemption Reports of Brokers and Dealers	.05
AT 101	Attest Engagements	.103

PCAOB Standard, Auditing Interpretation, Rule, or Form AP	Title	Paragraphs Amended
Rule 1001	Definitions of Terms Employed in Rules	(p)(ii)
Rule 3211	Auditor Reporting of Certain Audit Participants	Note 1 to paragraph (a)
Form AP	Auditor Reporting of Certain Audit Participants	Note 1 to General Instruction 3, Item 3.2, Item 3.3, Item 5.1

Note: The amended paragraphs referenced above include revisions to the accompanying footnotes.

Rescission of AS 1205

I. AS 1205 is rescinded.

Amendment to AS 1210

II. AS 1210 is amended by adding footnote 1A to paragraph .03 to read as follows:

.03 The engagement partner and, as applicable, other engagement team^{1A} members performing supervisory activities¹ should assess the specialist's knowledge, skill, and ability in the particular field for the type of work under consideration. This includes obtaining an

understanding of the following with respect to the specialist and the entity that employs the specialist:

^{1A} The term "engagement team," as used in this standard, has the same meaning as defined in Appendix A of AS 2101, *Audit Planning*.

Amendments to AS 1301

III. AS 1301 is amended by revising paragraph .10e and footnotes 12 and 13 to paragraph .10 to read as follows:

.10 As part of communicating the overall audit strategy, the auditor should communicate the following matters to the audit committee, if applicable:

e. In an audit that involves other auditors or referred-to auditors, the basis for the engagement partner's determination that the participation of his or her firm is sufficient to serve as 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 in multi-location engagements.

¹³ The terms "lead auditor," "other auditor," and "referred-to auditor," as used in this standard, have the same meaning as defined in Appendix A of AS 2101. *See* AS 2101.06A–.06C, which establish requirements regarding serving as the lead auditor.

IV. AS 1301 is amended by adding footnote 27A to paragraph .15 to read as follows:

.15 The auditor should communicate to the audit committee matters that are difficult or contentious for which the auditor consulted outside the engagement team^{27A} and that the auditor reasonably determined are relevant to the audit committee's oversight of the financial reporting process.

^{27A} The term "engagement team," as used in this standard, has the same meaning as defined in Appendix A of AS 2101.

Amendments to AS 2110

V. AS 2110 is amended by adding footnote 4A to paragraph .05e to read as follows:

- e. Conducting a discussion among engagement team^{4A} members regarding the risks of material misstatement (paragraphs .49–.53); and

^{4A} The term "engagement team," as used in this standard, has the same meaning as defined in Appendix A of AS 2101, *Audit Planning*.

VI. AS 2110 is amended by inserting new paragraph .11A after paragraph .11:

.11A If the auditor serves as a referred-to auditor in a divided-responsibility audit,^{7A} as part of obtaining an understanding of the company, the referred-to auditor should consider making inquiries of the lead auditor as to matters that may be significant to the referred-to auditor's own

audit. Such matters may include transactions, adjustments, or other matters that have come to the attention of the lead auditor and that may require adjustment to or disclosure in the financial statements audited by the referred-to auditor.

^{7A} See AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*.

VII. AS 2110 is amended by changing the footnote reference in paragraph .13 from 7A to 7B:

^{7B} See AS 2401.66–.67A.

VIII. AS 2110 is amended by revising footnote 26 to paragraph .45 to read as follows:

²⁶ Paragraph .07 of AS 2101.

IX. AS 2110 is amended by adding a new footnote 35A to the end of paragraph .64:

^{35A} See also AS 2101.11–.12, which describe additional risk assessment considerations for multi-location engagements.

Amendments to AS 2201

X. AS 2201 is amended by adding footnote 7A to paragraph .09 to read as follows:

.09 The auditor should properly plan the audit of internal control over financial reporting and properly supervise the engagement team^{7A} members. When planning an integrated audit, 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 –

^{7A} The term "engagement team," as used in this standard, has the same meaning as defined in Appendix A of AS 2101, *Audit Planning*.

XI. AS 2201 is amended by revising paragraph .B23 to read as follows:

.B23 In determining whether the service auditor's report provides sufficient evidence to support the auditor's opinion, the auditor should make inquiries concerning the service auditor's reputation, competence, and independence. Appropriate sources of information concerning the professional reputation of the service auditor may include professional organizations and other relevant parties.

XII. AS 2201 is amended by revising subparagraph (c) of paragraph .C1 to read as follows:

- c. The auditor decides to refer to the report of another public accounting firm as the basis, in part, for the auditor's own report,

XIII. AS 2201 is amended by revising paragraph .C8 to read as follows:

.C8 *Opinions Based, in Part, on the Report of Another Public Accounting Firm.* Because an audit of the financial statements must be performed to audit internal control over financial reporting, only the lead auditor of the financial statements can be the lead auditor of internal control over financial reporting. In an audit that involves other auditors or referred-to auditors,

the lead auditor of the consolidated 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. AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*, establishes requirements for situations in which the lead auditor of the consolidated financial statements and, if applicable, internal control over financial reporting makes reference in the auditor's report to the report of another public accounting firm on the financial statements and, if applicable, internal control over financial reporting of one or more of the company's business units. See Appendix A of AS 2101, *Audit Planning*, for the definitions of "lead auditor," "other auditor," and "referred-to auditor." See also AS 2101.06A–.06C, which establish requirements regarding serving as the lead auditor.

XIV. AS 2201 is amended by deleting paragraph .C9 and inserting the following language:

[.C9] [Paragraph deleted.]

XV. AS 2201 is amended by revising paragraph .C10 to read as follows:

.C10 The lead auditor's decision about making reference to the referred-to auditor in the 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. For example, the audit report on the financial statements may make reference to the audit of a significant equity investment performed by the referred-to auditor, but the report on internal control over financial reporting might not make a similar reference because management's assessment of internal control over financial reporting ordinarily would not extend to controls at the equity method investee.¹

¹ See paragraph .B15, for further discussion of the evaluation of the controls over financial reporting for an equity method investment.

XVI. AS 2201 is amended by revising paragraph .C11 to read as follows:

.C11 When the lead auditor makes reference to the report of the referred-to auditor as a basis, in part, for the lead auditor's opinion on the company's internal control over financial reporting, the lead auditor should refer to the report of the referred-to auditor as discussed in AS 1206.

Amendment to AS 2301

XVII. AS 2301 is amended by adding footnote 1A to paragraph .05a to read as follows:

- a. *Making appropriate assignments of significant engagement responsibilities.* The knowledge, skill, and ability of engagement team^{1A} members with significant engagement responsibilities should be commensurate with the assessed risks of material misstatement.¹

^{1A} The term "engagement team," as used in this standard, has the same meaning as defined in Appendix A of AS 2101, *Audit Planning*.

Amendments to AS 2401

XVIII. AS 2401 is amended by revising the sixth bullet of paragraph .53 to read as follows:

- If other auditors or referred-to auditors^{20A} are auditing the financial statements of one or more of the company's locations or business units,^{20B} where applicable, discussing with them the extent of work that needs to be performed to address the

fraud risk resulting from transactions and activities relating to these locations or business units.

^{20A} The terms "other auditor" and "referred-to auditor," as used in this standard, have the same meaning as defined in Appendix A of AS 2101, *Audit Planning*.

^{20B} The term "business units" includes subsidiaries, divisions, branches, components, or investments.

XIX. AS 2401 is amended by revising the fifth bullet of paragraph .61 to read as follows:

- *The nature and complexity of the accounts.* Inappropriate journal entries or adjustments may be applied to accounts that (a) contain transactions that are complex or unusual in nature, (b) contain significant estimates and period-end adjustments, (c) have been prone to errors in the past, (d) have not been reconciled on a timely basis or contain unreconciled differences, (e) contain intercompany transactions, or (f) are otherwise associated with an identified fraud risk. The auditor should recognize, however, that inappropriate journal entries and adjustments also might be made to other accounts. In audits of entities that have multiple locations or business units, the auditor should determine whether to select journal entries from locations or business units based on factors set forth in AS 2101.11–.14.

Amendments to AS 2410

XX. AS 2410 is amended by revising subparagraph (c) of paragraph .03 to read as follows:

- c. Communicating with the engagement team and referred-to auditors (paragraphs .08–.09).^{2A}

^{2A} The terms "engagement team" and "referred-to auditor," as used in this standard, have the same meaning as defined in Appendix A of AS 2101, *Audit Planning*.

XXI. AS 2410 is amended by revising the subheading before paragraph .08 to read as follows:

Communicating with the Engagement Team and Referred-to Auditors

XXII. AS 2410 is amended by revising paragraph .09 to read as follows:

.09 If the auditor serves as the lead auditor and divides responsibility for the audit with a referred-to auditor, the lead auditor should communicate to the referred-to auditor relevant information about related parties, including the names of the company's related parties and the nature of the company's relationships and transactions with those related parties.⁹ The lead auditor also should inquire of the referred-to auditor regarding the referred-to auditor's knowledge of any related parties or relationships or transactions with related parties that were not included in the auditor's communications.

⁹ 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–.06C, which establish requirements regarding serving as the lead auditor. *See also* AS 1206, *Dividing Responsibility for the Audit with Another*

Accounting Firm, which establishes requirements for the lead auditor regarding dividing responsibility for the audit with a referred-to auditor.

XXIII. AS 2410 is amended by revising subparagraph (c) of paragraph .16 to read as follows:

- c. Promptly communicate to appropriate members of the engagement team and the referred-to auditor relevant information about the related party or relationship or transaction with the related party;

Amendments to AS 2601

XXIV. AS 2601 is amended by revising paragraph .01 to read as follows:

.01 This section provides guidance on the factors an independent auditor should consider when auditing the financial statements of an entity that uses a service organization to process certain transactions. This section also provides guidance for independent auditors who issue reports on the processing of transactions by a service organization for use by another auditor.

Note: When performing an integrated audit of financial statements and internal control over financial reporting, refer to paragraphs .B17–.B27 of Appendix B, *Special Topics*, of AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, regarding the use of service organizations.

XXV. AS 2601 is amended by revising paragraph .18 to read as follows:

.18 In considering whether the service auditor's report is satisfactory for his or her purposes, the user auditor should make inquiries concerning the service auditor's professional reputation.

Appropriate sources of information concerning the professional reputation of the service auditor may include professional organizations and other relevant parties.

XXVI. AS 2601 is amended by revising paragraph .19 to read as follows:

.19 In considering whether the service auditor's report is sufficient to meet his or her objectives, the user auditor should consider performing one or more of the following procedures:

- Visiting the service auditor and discussing the audit procedures followed and the results thereof.
- Reviewing the audit programs of the service auditor. In some cases, it may be appropriate to issue instructions to the service auditor as to the scope of the audit work.
- Reviewing additional audit documentation of the service auditor.

If the user auditor believes that the service auditor's report may not be sufficient to meet his or her objectives, the user auditor may supplement his or her understanding of the service auditor's procedures and conclusions by discussing with the service auditor the scope and results of the service auditor's work. Also, if the user auditor believes it is necessary, he or she may contact the service organization, through the user organization, to request that the service auditor perform agreed-upon procedures at the service organization, or the user auditor may perform such procedures.

Amendment to AS 2605

XXVII. AS 2605 is amended by revising paragraph .19 to read as follows:

.19 The responsibility to report on the financial statements rests solely with the auditor. Unlike the situation in which the auditor divides responsibility for the audit with another public accounting firm,⁶ this responsibility cannot be shared with the internal auditors. Because the auditor has the ultimate responsibility to express an opinion on the financial statements, judgments about assessments of inherent and control risks, the materiality of misstatements, the sufficiency of tests performed, the evaluation of significant accounting estimates, and other matters affecting the auditor's report should always be those of the auditor.

⁶ See AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*.

Amendments to AS 2610

XXVIII. AS 2610 is amended by revising footnote 8 to paragraph .12 to read as follows:

⁸ The successor auditor may wish to make inquiries about the professional reputation and standing of the predecessor auditor to one or more professional organizations or other relevant parties.

XXIX. AS 2610 is amended by revising paragraph .16 to read as follows:

.16 The successor auditor should plan and perform the reaudit in accordance with the standards of the PCAOB. The successor auditor should not assume responsibility for the predecessor auditor's work or divide responsibility for the reaudit with the predecessor auditor,

as described in AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*. Furthermore, the predecessor auditor is not an auditor's specialist, nor does the predecessor auditor's work constitute the work of others as described in AS 2605, *Consideration of the Internal Audit Function*, or paragraphs .16–.19 of AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.

Amendment to AS 2710

XXX. AS 2710 is amended by revising footnote 2 to paragraph .04 to read as follows:

² In fulfilling his responsibility under this section, a lead auditor may also request the other auditor or referred-to auditor to read the other information. If a predecessor auditor's report appears in a document to which this section applies, he should read the other information for the reasons described in this paragraph. (See Appendix A of AS 2101, *Audit Planning*, for the definitions of "lead auditor," "other auditor," and "referred-to auditor.")

Amendment to AS 2810

XXXI. AS 2810 is amended by adding footnote 17A to paragraph .29 to read as follows:

.29 As part of this evaluation, the engagement partner should determine whether there has been appropriate communication with the other engagement team^{17A} members throughout the audit regarding information or conditions that are indicative of fraud risks.

^{17A} The term "engagement team," as used in this standard, has the same meaning as defined in Appendix A of AS 2101, *Audit Planning*.

Amendments to AS 3101

XXXII. AS 3101 is amended by adding footnote 20A to paragraph .12e to read as follows:

- e. The nature and extent of audit effort required to address the matter, including the extent of specialized skill or knowledge needed or the nature of consultations outside the engagement team^{20A} regarding the matter; and

^{20A} The term "engagement team," as used in this standard, has the same meaning as defined in Appendix A of AS 2101, *Audit Planning*.

XXXIII. AS 3101 is amended by revising subparagraph (b) of paragraph .18 to read as follows:

- b. The auditor divides responsibility with, and makes reference in the auditor's report to the audit and report of, another public accounting firm;²⁴

²⁴ AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*, establishes requirements for situations in which the auditor of the consolidated financial statements (the "lead auditor," as defined in Appendix A to AS 2101) makes reference in the auditor's report to the report of another public accounting firm that audited the financial statements of one or more of the company's business units (the "referred-to auditor," as defined in Appendix A to AS 2101). (*See also* paragraphs .06A–.06C of AS 2101, which establish requirements regarding serving as the lead auditor.)

Amendment to AS 3105

XXXIV. AS 3105 is amended by revising paragraph .55 to read as follows

.55 Before reissuing (or consenting to the reuse of) a report previously issued on the financial statements of a prior period, when those financial statements are to be presented on a comparative basis with audited financial statements of a subsequent period, a predecessor auditor should consider whether his or her previous report on those statements is still appropriate. Either the current form or manner of presentation of the financial statements of the prior period or one or more subsequent events might make a predecessor auditor's previous report inappropriate. Consequently, a predecessor auditor should (a) read the financial statements of the current period, (b) compare the prior-period financial statements that he or she reported on with the financial statements to be presented for comparative purposes, and (c) obtain representation letters from management of the former client and from the successor auditor. The representation letter from management of the former client should state (a) whether any information has come to management's attention that would cause them to believe that any of the previous representations should be modified, and (b) whether any events have occurred subsequent to the balance-sheet date of the latest prior-period financial statements reported on by the predecessor auditor that would require adjustment to or disclosure in those financial statements.¹⁷ The representation letter from the successor auditor should state whether the successor's audit revealed any matters that, in the successor's opinion, might have a material effect on, or require disclosure in, the financial statements reported on by the predecessor auditor. Also, the predecessor auditor may wish to consider (a) making inquiries about the professional reputation and standing of the successor auditor,^{17A} (b) obtaining a representation from the successor auditor that he or she is independent under the requirements of the PCAOB and the Securities

and Exchange Commission, and (c) making inquiries of the successor auditor to determine that the successor auditor knows the relevant requirements of the applicable financial reporting framework, standards of the PCAOB, and financial reporting requirements of the Securities and Exchange Commission. However, the predecessor auditor should not refer in his or her reissued report to the report or work of the successor auditor.

¹⁷ See AS 2805, *Management Representations*, Appendix C [paragraph .18], "Illustrative Updating Management Representation Letter."

^{17A} Inquiries may be made to one or more professional organizations or other relevant parties.

Amendment to AS 3305

XXXV. AS 3305 is amended by revising subparagraph (c) of paragraph .31 to read as follows:

- c. *Referred-to Auditors.* When the auditor divides responsibility for the audit with another public accounting firm, the auditor's report should make reference to the audit and report of the referred-to auditor in compliance with the requirements of paragraphs .08–.09 of AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*.⁴⁰

⁴⁰ AS 1206 establishes requirements for situations in which the auditor of the consolidated financial statements (the "lead auditor," as defined in Appendix A of AS 2101, *Audit Planning*) makes reference in the auditor's report to the report of another public accounting firm that audited the financial statements of one or more of the company's business units (the

"referred-to auditor," as defined in Appendix A of AS 2101). (*See also* paragraphs .06A–.06C of AS 2101, which establish requirements regarding serving as the lead auditor.)

Amendments to AS 4105

XXXVI. AS 4105 is amended by revising paragraph .18b to read as follows:

- b. Obtaining reports from other accountants, if any, who have been engaged to perform a review of the interim financial information of significant components of the reporting entity or its other business units, or inquiring of those accountants if reports have not been issued.¹¹

¹¹ In these circumstances, the accountant ordinarily is in a position similar to that of, as applicable, a lead auditor that obtains the results of the work of an other auditor (*see generally* AS 1201, *Supervision of the Audit Engagement*, and AS 2101, *Audit Planning*), or an investor's auditor that obtains a report from an investee's auditor (*see generally* Appendix B of AS 1105, *Audit Evidence*).

XXXVII. AS 4105 is amended by revising footnote 28 to paragraph .39 to read as follows:

²⁸ If the auditor's report on the preceding year-end financial statements was other than unqualified, made reference to an audit and report of another public accounting firm, or included an explanatory paragraph because of a going-concern matter or an inconsistency in the application of accounting principles, the second paragraph of the illustrative report in paragraph .39 should be appropriately modified.

XXXVIII. AS 4105 is amended by revising footnote 29 to paragraph .40 to read as follows:

²⁹ See AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*.

XXXIX. AS 4105 is amended by adding footnote 35 to paragraph .52 to read as follows

.52 Because of the different circumstances in individual engagements, it is not possible to specify the form or content of the documentation the accountant should prepare. However, the documentation should include any findings or issues that in the accountant's judgment are significant, for example, the results of review procedures that indicate that the interim financial information could be materially misstated, including actions taken to address such findings, and the basis for the final conclusions reached. In addition, the documentation should (a) enable members of the engagement team³⁵ with supervision and review responsibilities to understand the nature, timing, extent, and results of the review procedures performed; (b) identify the engagement team member(s) who performed and reviewed the work; and (c) identify the evidence the accountant obtained in support of the conclusion that the interim financial information being reviewed agreed or reconciled with the accounting records (see paragraph .18(d) of this section).

³⁵ The term "engagement team," as used in this standard for review engagements, has a meaning analogous to the term's definition in Appendix A of AS 2101 for audit engagements.

Amendments to AS 6115

XL. AS 6115 is amended by revising paragraph .24 to read as follows:

.24 The auditor should properly plan the engagement to report on whether a previously reported material weakness continues to exist and should properly supervise engagement team^{2A} members. When planning the engagement, the auditor should evaluate how the matters described in AS 2201.09 will affect the auditor's procedures.

^{2A} The term "engagement team," as used in this standard, has the same meaning as defined in Appendix A of AS 2101, *Audit Planning*.

XLI. AS 6115 is amended by revising the heading before paragraph .40 to read as follows:

Engagements Involving Other Accounting Firms

XLII. AS 6115 is amended by revising paragraph .40 to read as follows:

.40 If an engagement to report on whether a previously reported material weakness continues to exist involves another accounting firm, the lead auditor⁴ must not divide responsibility for the engagement with the other accounting firm.

⁴ 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–.06C, which establish requirements regarding serving as the lead auditor. *See also* AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*.

Rescission of AI 10

XLIII. AI 10 is rescinded.

Amendment to AI 28

XLIV. AI 28 is amended by revising paragraph .12 to read as follows:

.12 *Interpretation*—Audit documentation is the written record of auditing procedures applied, evidence obtained, and conclusions reached by the auditor in the engagement. Audit documentation should include sufficient appropriate evidential matter to afford a reasonable basis for an opinion. In addition, audit documentation should be sufficient to enable members of the engagement team with supervision and review responsibilities to understand the nature, timing, extent, and results of auditing procedures performed, and the evidence obtained. *See AS 1215, Audit Documentation.*

Amendment to AT 1

XLV. AT 1 is amended by adding footnote 10A to the first note to paragraph 6 to read as follows:

Note: Due professional care imposes a responsibility on each engagement team^{10A} member to comply with this standard. The exercise of due professional care requires critical review at every level of supervision of the work done and the judgment exercised by those assisting in the engagement, including preparing the report.¹¹

^{10A} The term "engagement team," as used in this standard for examination engagements, has a meaning analogous to the term's definition in Appendix A of AS 2101, *Audit Planning*, for audit engagements.

Amendment to AT 2

XLVI. AT 2 is amended by adding footnote 7A to the first note to paragraph 5 to read as follows:

Note: Due professional care imposes a responsibility on each engagement team^{7A} member to comply with this standard. The exercise of due professional care requires critical review at every level of supervision of the work done and the judgment exercised by those assisting in the engagement, including preparing the report.⁸

^{7A} The term "engagement team," as used in this standard for review engagements, has a meaning analogous to the term's definition in Appendix A of AS 2101, *Audit Planning*, for audit engagements.

Amendment to AT 101

XLVII. AT 101 is amended by adding footnote 22A to paragraph .103 to read as follows:

.103 Attest documentation should be sufficient to (a) enable members of the engagement team^{22A} with supervision and review responsibilities to understand the nature, timing, extent, and results of attest procedures performed, and the information obtained²³ and (b) indicate the

engagement team member(s) who performed and reviewed the work. [Paragraph added, effective for attest engagements when the subject matter or assertion is as of or for a period ending on or after December 15, 2002, by Statement on Standards for Attestation Engagements No. 11.]

^{22A} The term "engagement team," as used in this standard for attest engagements, has a meaning analogous to the term's definition in Appendix A of AS 2101, *Audit Planning*, for audit engagements.

Amendment to Rule 1001

XLVIII. Section 1. General Provisions, Rule 1001 is amended by revising paragraph (p)(ii) to read as follows:

(p)(ii) Play a Substantial Role in the Preparation or Furnishing of an Audit Report

The phrase "play a substantial role in the preparation or furnishing of an audit report" means –

- (1) to perform material services that a public accounting firm uses or relies on in issuing all or part of its audit report, or
- (2) to perform the majority of the audit procedures with respect to a subsidiary or component of any issuer, broker, or dealer, the assets or revenues of which constitute 20% or more of the consolidated assets or revenues of such issuer, broker, or dealer necessary for the lead auditor to issue an audit report.

Note 1: For purposes of paragraph (1) of this definition, the term "material services" means services, for which the engagement hours or fees constitute 20% or more of the total engagement hours or fees, respectively, provided by the lead auditor in connection with the issuance of all or part of its audit report. The term does not include non-audit services provided to non-audit clients.

Note 2: For purposes of paragraph (2) of this definition, the phrase "subsidiary or component" is meant to include any subsidiary, division, branch, office or other component of an issuer, broker, or dealer, regardless of its form of organization and/or control relationship with the issuer, broker, or dealer.

Note 3: For purposes of determining "20% or more of the consolidated assets or revenues" under paragraph (2) of this Rule, this determination should be made at the beginning of the issuer's, broker's, or dealer's fiscal year using prior year information and should be made only once during the issuer's, broker's, or dealer's fiscal year.

Amendment to Rule 3211

XLIX. Rule 3211 is amended by revising Note 1 to paragraph (a) to read as follows:

Note 1: A Form AP filing is not required for an audit report of a registered public accounting firm that is referred to by the lead auditor in accordance with AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*.

Amendments to Form AP Instructions

- L.** The Form AP instructions are amended by revising Note 1 to General Instruction 3 to read as follows:

Note 1: A Form AP filing is not required for an *audit report* of a *registered public accounting firm* that is referred to by the Firm in accordance with AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*.

- LI.** The Form AP instructions are amended by revising the Note to Item 3.2 to read as follows:

Note: For purposes of Item 3.2, an *other accounting firm* participated in the Firm's audit if the *other accounting firm* or any of its principals or professional employees was subject to supervision under AS 1201, *Supervision of the Audit Engagement*.

- LII.** The Form AP instructions are amended by revising Item 3.3 to read as follows:

Item 3.3 Divided Responsibility

Indicate, by checking the box corresponding to this item, if the Firm divided responsibility for the *audit* in accordance with AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*, with one or more other *public accounting firm(s)*. If this item is checked, complete Part V.

- LIII.** The Form AP instructions are amended by revising Item 5.1 to read as follows:

Item 5.1 Identity of the Other *Public Accounting Firm(s)* When Responsibility Is Divided

- (a) Provide the following information concerning each other *public accounting firm* the Firm divided responsibility with in the *audit*—
- (1) State the legal name of the other *public accounting firm* and when applicable, the other *public accounting firm's* Firm ID.
 - (2) State the city and state (or, if outside the United States, city and country) of the office of the other *public accounting firm* that issued the other *audit report*.
 - (3) State the magnitude of the portion of the financial statements audited by the other *public accounting firm*.

Note: In responding to Item 5.1.a.3, the Firm should state the dollar amounts or percentages of one of the following: total assets, total revenues, or other appropriate criteria, as it is described in the *audit report* in accordance with AS 1206.

EXHIBIT 1**SECURITIES AND EXCHANGE COMMISSION**

(Release No. 34-XXXXX; File No. PCAOB-2022-01

[Date]

Public Company Accounting Oversight Board; Notice of Filing of Proposed Rules on Planning and Supervision of Audits Involving Other Auditors and Dividing Responsibility for the Audit with Another Accounting Firm

Pursuant to Section 107(b) of the Sarbanes-Oxley Act of 2002 ("Act"), notice is hereby given that on [Date of Form 19b-4 Submission], the Public Company Accounting Oversight Board (the "Board" or the "PCAOB") filed with the Securities and Exchange Commission (the "Commission" or the "SEC") the proposed rules described in items I and II below, which items have been prepared by the Board. The Commission is publishing this notice to solicit comments on the proposed rules from interested persons.

I. Board's Statement of the Terms of Substance of the Proposed Rules

On June 21, 2022, the Board adopted "Planning and Supervision of Audits Involving Other Auditors and Dividing Responsibility for the Audit with Another Accounting Firm" and related amendments to its auditing standards, attestation standards, auditing interpretations, rules, and a form (collectively, the "proposed rules"). The text of the proposed rules appears in Exhibit A to the SEC Filing Form 19b-4 and is available on the Board's website at

<https://pcaobus.org/about/rules-rulemaking/rulemaking-dockets/docket-042-proposed-amendments-relating-to-the-supervision-of-audits-involving-other-auditors-and-proposed-auditing-standard> and at the Commission's Public Reference Room.

II. Board's Statement of the Purpose of, and Statutory Basis for, the Proposed Rules

In its filing with the Commission, the Board included statements concerning the purpose of, and basis for, the proposed rules and discussed any comments it received on the proposed rules. The text of these statements may be examined at the places specified in Item IV below. The Board has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements. In addition, the Board is requesting that the Commission approve the proposed rules, pursuant to Section 103(a)(3)(C) of the Act, for application to audits of emerging growth companies ("EGCs"), as that term is defined in Section 3(a)(80) of the Securities Exchange Act of 1934 ("Exchange Act"). The Board's request is set forth in section D.

A. Board's Statement of the Purpose of, and Statutory Basis for, the Proposed Rules

(1) Purpose

Summary

The Board has adopted amendments to its auditing standards to strengthen requirements for planning and supervising audits involving accounting firms and individual accountants (collectively, "other auditors") outside the accounting firm that issues the auditor's report (the "lead auditor"). In these audits, the lead auditor issues the audit report on the company's consolidated financial statements, but other auditors often perform important work on the audit. The roles of other auditors have increased as companies' global operations have grown. In addition, the Board adopted a new auditing standard that will apply when the lead auditor divides responsibility for an audit with another accounting firm ("referred-to auditor").

Working with other auditors and referred-to 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 their work and can reduce audit quality. 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 audit report.

This rulemaking is intended to increase and improve the lead auditor's involvement in and evaluation of the other auditors' work. The Board believed that the heightened attention to other auditors' work will improve communication among auditors and the lead auditor's ability to prevent or detect deficiencies in that work, and thus enhance the quality of audits involving other auditors and promote investor protection.

The amendments to the Board's auditing standards are intended to improve PCAOB standards principally by (i) applying a risk-based supervisory approach to the lead auditor's oversight of other auditors and (ii) requiring that the lead auditor perform certain procedures when planning and supervising an audit that involves other auditors. The amendments have taken into account recent practice developments in the lead auditor's oversight of other auditors' work, including the greater use of communication technology. In brief, the amendments:

- Require that the engagement partner determine whether his or her firm's participation in the audit is sufficient for the firm to carry out the responsibilities of a lead auditor and report as such. The amendments also provide considerations for the engagement partner to use in making this determination and require that the audit's engagement quality reviewer review the determination.
- Require that the lead auditor, when determining the engagement's compliance with independence and ethics requirements, understand the other auditors' knowledge of

those requirements and experience in applying them. The amendments also require that the lead auditor obtain and review written affirmations regarding the other auditors' policies and procedures related to those requirements and regarding compliance with the requirements, and a description of certain auditor-client relationships related to independence. In addition, the amendments require the sharing of information about changes in circumstances and the updating of affirmations and descriptions in light of those changes.

- Require that the lead auditor understand the knowledge, skill, and ability of other auditors' engagement team members who assist the lead auditor with planning and supervision, and obtain a written affirmation from other auditors that their engagement team members possess the knowledge, skill, and ability to perform assigned tasks.
- Require that the lead auditor supervise other auditors under the Board's standard on audit supervision and inform other auditors about the scope of their work, identified risks of material misstatement, and certain other key matters. The amendments also require that the lead auditor and other auditors communicate about the audit procedures to be performed, and any changes needed to the procedures. In addition, the amendments require the lead auditor to obtain and review written affirmations from other auditors about their performance of work in accordance with the lead auditor's instructions, and to direct other auditors to provide certain documentation about their work.
- Provide that, in multi-tiered audits, a first other auditor may assist the lead auditor in performing certain required procedures with respect to second other auditors.

This rulemaking rescinds an interim standard but carries forward and strengthens some of its requirements in a new standard that applies to those infrequent situations where the lead auditor divides responsibility for a portion of the audit with another audit firm and therefore does not supervise the work performed by that firm. In these situations, the lead auditor refers in the audit report to the work of that auditor (i.e., a referred-to auditor). This new standard requires that in these situations the lead auditor determine that audit procedures were performed regarding the consolidation or combination of financial statements of the business units audited by the referred-to auditor into the company's financial statements. The standard also requires that the lead auditor obtain the referred-to auditor's written representation that it is independent and duly licensed to practice, and that the lead auditor disclose in the audit report the magnitude of the portion of the financial statements and, if applicable, internal controls audited by the referred-to auditor.

The Board has adopted the amendments and new standard after three rounds of public comment. Commenters generally expressed support for the rulemaking's objective of improving the quality of audits involving other auditors and referred-to auditors. They also suggested ways to revise or clarify the proposed amendments and standard. The Board took into account these comments, as well as observations of the Board and its staff through PCAOB oversight activities (including audit inspections and enforcement cases).

The amendments and new standard apply to all audits conducted under PCAOB standards. Subject to approval by the Securities and Exchange Commission ("SEC" or "Commission"), the amendments and new standard will take effect for audits for fiscal years ending on or after December 15, 2024.

(b) Statutory Basis

The statutory basis for the proposed rules is Title I of the Act.

B. Board's Statement on Burden on Competition

Not applicable. The Board's consideration of economic impacts of the proposed rules is discussed in section D below.

C. Board's Statement on Comments on the Proposed Rules Received from Members, Participants or Others

The Board released the proposed rule amendment for public comment in PCAOB Release No. 2016-002 (Apr. 12, 2016). The Board received 23 written comment letters on that release. The Board issued a supplemental request for public comment in PCAOB Release No. 2017-005 (Sept. 26, 2017). The Board received 22 written comment letters on that release. The Board issued a second supplemental request for public comment in PCAOB Release No. 2021-005 (Sept. 28, 2021). The Board received 19 written comment letters on that release. The Board has carefully considered all comments received. The Board's response to the comments it received and the changes made to the proposed rules in response to the comments received are discussed below.

Background

This rulemaking addresses the responsibilities of the lead auditor (i.e., the audit firm that issues the auditor's report) in planning and supervising an audit that involves the work of other auditors. In formulating the approach, the Board sought public comment several times. In April 2016, the Board issued a proposal ("2016 Proposal") to amend our auditing standards and issue a new standard, to strengthen the requirements for lead auditors in audits that involve other

auditors and referred-to auditors.¹⁹ In September 2017, after considering public comments on the 2016 Proposal, the Board issued a supplemental request for comment ("2017 SRC") on certain targeted revisions to the proposed amendments.²⁰ In September 2021, after considering the public comments on the prior releases, the Board issued a second supplemental request for comment ("2021 SRC") to seek additional public comment on certain revisions to the amendments and other matters.²¹

Commenters on the 2016 Proposal, 2017 SRC, and 2021 SRC (collectively, the "proposing releases") generally expressed support for the rulemaking's objective of improving the quality of audits involving other auditors and referred-to auditors. They also suggested ways to revise or clarify the proposed amendments and standard. The Board considered all of the comments and adopted the amendments and standard (collectively "amendments" or "final amendments") for the reasons discussed below.

Rulemaking History

In the 2016 Proposal, the Board proposed to amend PCAOB auditing standards to strengthen existing requirements and impose a more uniform approach to the lead auditor's

¹⁹ 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).

²⁰ 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).

²¹ 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 (Sept. 28, 2021).

supervision of other auditors.²² 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 a portion of the audit with another accounting firm and refers to the referred-to auditor's report in the lead auditor's report. The Board received 23 comment letters on the 2016 Proposal.²³ Commenters generally expressed support for the rulemaking's objective of improving the quality of audits involving other auditors and referred-to auditors. Some expressed concerns or requested clarification about certain proposed requirements.

In response to the input from commenters, the Board issued a supplemental request for comment on the 2016 Proposal in September 2017.²⁴ The 2017 SRC discussed significant comments received and presented revisions to the proposed amendments while leaving the overall proposed approach to the supervision of other auditors intact. The Board received 22 comment letters on the 2017 SRC.²⁵ 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.

After consideration of the comments on the 2017 SRC and further analysis of issues raised by commenters and developments in this area, the Board issued a second supplemental

²² See 2016 Proposal at Section II.

²³ See 2017 SRC at 6-7 (discussing comment letters received on the 2016 Proposal).

²⁴ 2017 SRC.

²⁵ See 2021 SRC at 7 (discussing comment letters received on the 2017 SRC).

request for comment in September 2021. The proposed revisions in the 2021 SRC were 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. The Board received 19 comment letters on the 2021 SRC. Commenters continued to generally express support for the project's objectives, and also suggested some changes to, or requested clarification or guidance on, certain proposed requirements. The Board has considered the comments on the 2021 SRC, as well as on the previous proposing releases, in developing the final amendments.²⁶ The Board has also considered the observations of the Board and its staff from PCAOB oversight activities.

Overview of Existing Requirements

This section discusses key provisions of existing PCAOB auditing standards that address lead auditor responsibilities involving the work of other auditors or referred-to auditors that participate in an audit. Depending on the circumstances of an audit involving other auditors, one of two standards applies, as described below.

In 2003, the Board adopted the standard known today as AS 1205, *Part of the Audit Performed by Other Independent Auditors* (at that time, AU sec. 543), when it adopted the auditing profession's standards then in existence.²⁷ AS 1205 imposes requirements on a lead

²⁶ The comment letters received on the 2016 Proposal, 2017 SRC, and 2021 SRC are available in the docket for this rulemaking on the PCAOB's website (<https://pcaobus.org/Rulemaking/Pages/Docket042Comments.aspx>).

²⁷ In 1963, the American Institute of Certified Public Accountants ("AICPA") issued a codification of auditing standards that included several paragraphs on using the work of other auditors or referred-to auditors. In 1971, the AICPA issued Statement on Auditing Procedure No. 45, *Using the Work and Reports of Other Auditors*, and in 1972 it codified the standard in section 543 of the Statement on Auditing Standards No. 1 (AU sec. 543). In 2003, the PCAOB adopted the auditing profession's standards in existence at that time, including AU sec. 543. *See*

auditor (or "principal auditor," in the terminology of AS 1205) that uses the work and reports of other independent auditors that have audited the financial statements of one or more subsidiaries, divisions, branches, components, or investments included in the financial statements audited by the lead auditor. These requirements relate to situations in which the lead auditor uses the work and reports of other auditors or referred-to auditors by (i) assuming responsibility for the other auditors' work or (ii) dividing responsibility for the audit with referred-to auditors and referring to their work and reports in the lead auditor's audit report.²⁸ Those "divided-responsibility" situations, as discussed below, are relatively uncommon.

In 2010, the Board adopted AS 1201, *Supervision of the Audit Engagement* (at that time, Auditing Standard No. 10), when it adopted eight new auditing standards that set forth the auditor's responsibilities for assessing and responding to risk in an audit.²⁹ AS 1201 governs the supervision of the audit engagement, including supervising the work of engagement team members outside the engagement partner's firm. Under existing PCAOB standards, the lead

Establishment of Interim Professional Auditing Standards, PCAOB Release No. 2003-006 (Apr. 18, 2003). In 2015, the PCAOB reorganized its auditing standards using a topical structure and a single, integrated numbering system. See *Reorganization of PCAOB Auditing Standards and Related Amendments to PCAOB Standards and Rules*, PCAOB Release No. 2015-002 (Mar. 31, 2015). As part of that rulemaking, AU sec. 543 was reorganized as AS 1205. The reorganization did not impose additional requirements on auditors or substantively change the requirements of that standard.

²⁸ For example, the lead auditor may divide responsibility for a portion of the audit with another firm if it is impracticable for the lead auditor to review the other firm's work. See AS 1205.06.

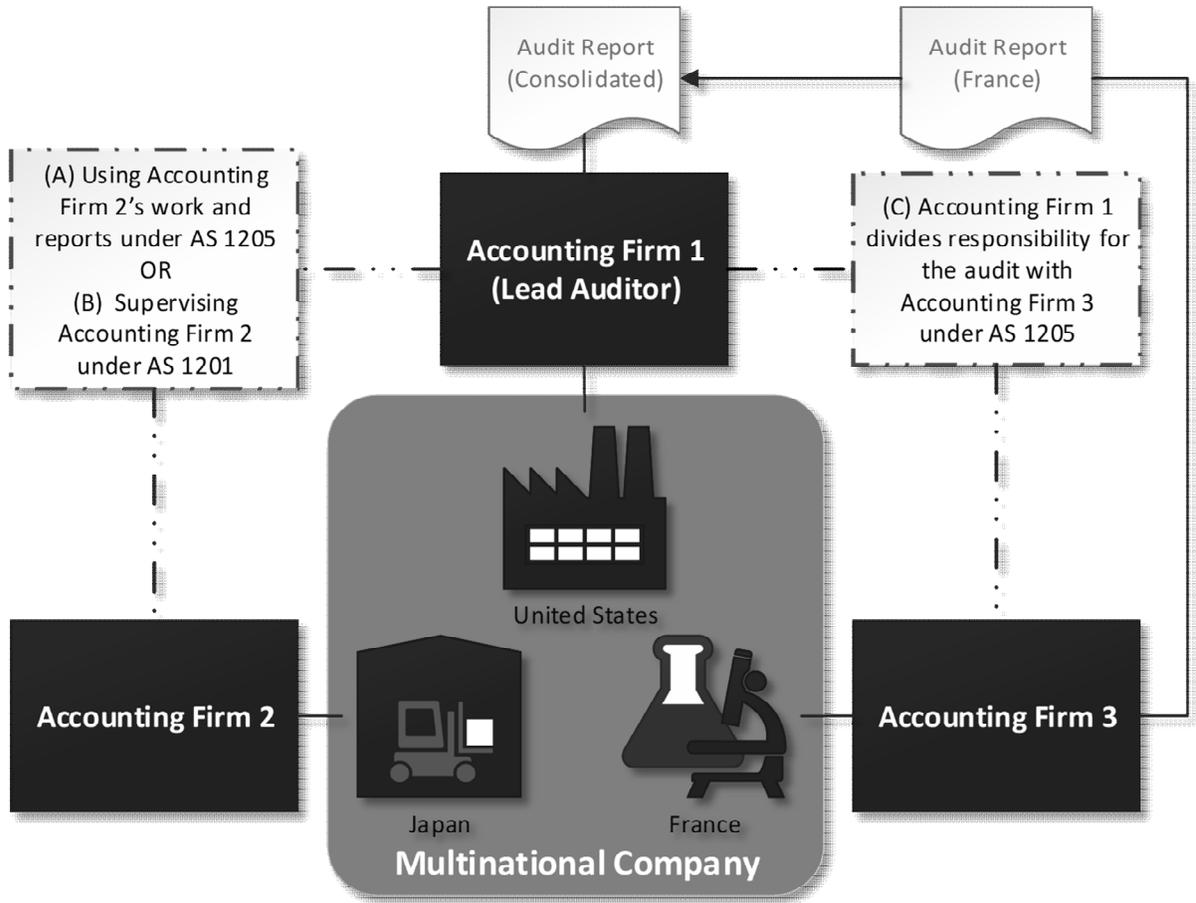
²⁹ *Auditing Standards Related to the Auditor's Assessment of and Response to Risk and Related Amendments to PCAOB Standards*, PCAOB Release No. 2010-004 (Aug. 5, 2010). Among other things, these risk assessment standards established risk-based requirements for determining the necessary audit work in multi-location audit engagements.

auditor supervises the work of another auditor under AS 1201 in situations not covered by AS 1205.³⁰

Figure 1 illustrates an example of a U.S.-based audit that involves other accounting firms, and the PCAOB auditing standards that apply to the audit. In the example, Accounting Firm 1 is the lead auditor, and it involves Accounting Firm 2 by either (A) assuming responsibility for the work and reports of Accounting Firm 2 in accordance with AS 1205, or (B) supervising the work of Accounting Firm 2 in accordance with AS 1201. The lead auditor (C) divides responsibility for part of the audit with Accounting Firm 3 in accordance with AS 1205 and refers to Accounting Firm 3 in the lead auditor's audit report on the consolidated financial statements.

³⁰ See second note to AS 1205.01.

Figure 1. Example of an Audit Involving Other Accounting Firms



The following discusses AS 1205 and AS 1201 in more detail:

(A) *Using the work and reports of other auditors under AS 1205.* If an auditor uses, and assumes responsibility for, the work and reports of other auditors that audited the financial statements of one or more subsidiaries, divisions, branches, components, or investments included in the financial statements presented, AS 1205 includes the following requirements:³¹

³¹ In addition, in situations governed by AS 1205, the lead auditor is required by the Board's standard on planning, AS 2101, *Audit Planning*, to perform procedures to determine the locations or business units at which audit procedures should be performed. See AS 2101.11–13. This also applies to situations in which the auditor divides responsibility with another accounting firm. See AS 2101.14.

- When significant parts of the audit are performed by other auditors (from the same network of firms as the lead auditor or outside the network), the auditor is required to decide whether its own participation in the audit is sufficient to enable it to serve as the lead auditor (or, in the language of AS 1205, the "principal auditor") and to report as lead auditor on the company's consolidated financial statements.³²
- Whether or not the lead auditor decides to make reference to the audit of the other auditor, the lead auditor is required to make inquiries about the professional reputation and independence of the other auditor.³³ In addition, the lead auditor is required to adopt appropriate measures to assure the coordination of its activities with those of the other auditor in order to achieve a proper review of the matters affecting the consolidating or combining of accounts in the financial statements. Those measures may include procedures to ascertain through communication with the other auditor:
 - That the other auditor is aware that the financial statements of the component which it is to audit are to be included in the financial statements on which the lead auditor will report, and that the other auditor's report will be relied upon (and, where applicable, referred to) by the lead auditor;

³² See AS 1205.02.

³³ AS 1205.10.

- That the other auditor is familiar with the accounting principles generally accepted in the United States and with the standards of the PCAOB, and will conduct its audit and issue its report in accordance with those standards;
- That the other auditor has knowledge of the SEC's financial reporting requirements; and
- That a review will be made of matters affecting elimination of intercompany transactions and accounts and, if appropriate, the uniformity of accounting practices among the components included in the financial statements.³⁴
- The lead auditor must obtain, review, and retain certain information from the other auditor before issuing the report, including an engagement completion document, a list of significant risks, the other auditor's responses to those risks, the results of the other auditor's related procedures, and significant deficiencies and material weaknesses in internal control over financial reporting.³⁵
- The lead auditor also should³⁶ consider performing one or more of the following procedures: visiting the other auditor, reviewing the audit programs

³⁴ AS 1205.10.c.

³⁵ AS 1205.12.

³⁶ The word "should," as used in the auditing and related professional practice standards, indicates responsibilities that are presumptively mandatory. See Paragraph (a)(2) of PCAOB Rule 3101, *Certain Terms Used in Auditing and Related Professional Practice Standards*. Rule 3101 also defines other terms, such as "must" and "may," that describe the degree of responsibility that the standards impose on auditors.

of the other auditor (and, in some cases, issuing instructions to the other auditor), and reviewing additional audit documentation of significant findings or issues in the engagement completion document.³⁷

(B) *Including the other auditors in the engagement team and supervising their work under AS 1201.* This standard governs the auditor's supervision of an audit engagement, including the work of other auditors who are members of the same engagement team, wherever they are located. AS 1201, as it relates to the supervision of other auditors on the engagement team, includes the following requirements:

- The engagement partner is responsible for the engagement and its performance.³⁸ The engagement partner may seek assistance from appropriate engagement team members in fulfilling his or her responsibilities for the engagement and its performance.³⁹ Engagement team members can be from the engagement partner's firm or outside the firm.
- The engagement partner and others who assist the engagement partner in supervising the work of other engagement team members are required to:
 - Inform the engagement team members of their responsibilities for the work they are to perform, including the objective of the procedures they are to perform, the nature, timing, and extent of those procedures, and matters that could affect those procedures;

³⁷ AS 1205.12.

³⁸ AS 1201.03.

³⁹ AS 1201.04.

- Direct the engagement team members to inform the engagement partner or supervisors of significant accounting and auditing issues arising during the audit; and
- Review the work of engagement team members to evaluate whether the work was performed and documented, the objectives of the procedures were achieved, and the results of the work support the conclusions reached.⁴⁰
- The engagement partner and others who assist the engagement partner in supervising the audit should determine the extent of supervision necessary for engagement team members to perform their work as directed and form appropriate conclusions. Under this standard, requirements for supervision are risk-based and scalable, and the necessary extent of supervision varies depending on, for example, the nature of the assigned work, the risks of material misstatement associated with that work, and the knowledge, skill, and ability of each individual involved.⁴¹

(C) *Dividing responsibility for the audit with another accounting firm.* AS 1205 also governs audits in which the lead auditor divides responsibility for the audit with another accounting firm that issues a separate auditor's report on the financial statements of one or more subsidiaries, divisions, branches, components, or investments included in the company's financial statements.⁴² The requirements of AS 1205 that apply under these

⁴⁰ AS 1201.05.

⁴¹ AS 1201.06.

⁴² For auditors' reports on non-issuer entities, where the principal accountant elects to place reliance on the work of the other accountant and makes reference to that effect in the

circumstances are more limited than the requirements that apply to the lead auditor's use of the work and reports of other auditors when the lead auditor assumes responsibility for the other auditor's work (discussed in item A above).⁴³ For example, AS 1205 does not require the lead auditor to obtain, review, and retain certain information from the accounting firm with which the lead auditor divides responsibility for the audit (which is required when the lead auditor assumes responsibility for another firm's work under AS 1205).⁴⁴ If the lead auditor refers in its report to the work of another firm, the lead auditor's report indicates the division of responsibility and the magnitude of the portion of the financial statements audited by the other firm.⁴⁵

Existing Practice

This section describes the state of practice – including the evolution of audit practices and related inspection findings – that the Board and its staff have observed in past years through PCAOB oversight activities (including through observations from audit inspections and enforcement cases).

Evolution of Auditing Practice at Accounting Firms

Auditors around the world, even when they perform audit procedures that are required to comply with PCAOB standards, may be influenced by international and home country auditing standards. With respect to the use of other auditors, the standards of the International Auditing

auditor's report, SEC rules require that the other accounting firm's report be filed with the SEC. See Rule 2-05 of Regulation S-X, 17 CFR 210.2-05.

⁴³ AS 1205.06–.09.

⁴⁴ AS 1205.12.

⁴⁵ AS 1205.07–.09.

and Assurance Standards Board ("IAASB") – specifically, International Standard on Auditing ("ISA") 600⁴⁶ – establishes requirements for "group audits."⁴⁷ ISA 600 was originally developed in the wake of several significant frauds that involved multinational groups of companies, audited by multiple accounting firms.⁴⁸ In December 2021, the IAASB approved amendments to ISA 600 in a project that was informed by, among other things, persistent deficiencies in group audits reported by the International Forum of Independent Audit Regulators ("IFIAR").⁴⁹

⁴⁶ ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* (effective for audits of group financial statements for periods beginning on or after December 15, 2009); ISA 600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* (effective for audits of group financial statements for periods beginning on or after December 15, 2023). *See also* AU-C Section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* (standard adopted by the AICPA's Auditing Standards Board ("ASB")).

⁴⁷ Under ISA 600, group audits are audits of "group financial statements" consisting of at least two "components." Group audits generally are performed by a "group engagement team" and one or more "component auditors" and may involve a single firm or multiple firms.

⁴⁸ *See, e.g.*, Koninklijke Ahold N.V. (Royal Ahold), A. Michiel Meurs, Cees van der Hoeven, Johannes Gerhardus Andreae, and Ture Roland Fahlin, SEC Accounting and Auditing Enforcement Release ("AAER") No. 2124 (Oct. 13, 2004); Lernout & Hauspie Speech Products, SEC AAER No. 1729 (Mar. 4, 2003); *In re Parmalat Finanziara, S.p.A.*, SEC AAER No. 2065 (July 28, 2004); *see also* Michael J. Jones, ed., *Creative Accounting, Fraud and International Accounting Scandals* (2011) (describing, in Part B, 58 high-profile accounting scandals across 12 countries, including the Royal Ahold and Parmalat cases).

⁴⁹ *See* paragraph 7 of IAASB, Invitation to Comment, *Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits* (Dec. 2015); *see also* IFIAR, 2017 Survey of Inspection Findings (Mar. 8, 2018), at 10 (showing group audits among the inspection themes with frequent findings in 2014-2017); IAASB, *Work Plan for 2015–2016: Enhancing Audit Quality and Preparing for the Future* (Dec. 2014), at 7 ("Concern [with ISA 600] has been expressed about: [t]he extent of the group auditor's involvement in the work of the component auditor ... ; [c]ommunication between the group auditor and the component auditor; [a]pplication of the concept of component materiality; [i]dentifying a component in complex situations; and [w]ork effort of the component auditor.").

Meanwhile, the PCAOB has observed through its oversight activities that, after the PCAOB and IAASB adopted their own standards on risk assessment, some audit firms, particularly some of the largest firms that work extensively with other auditors, revised their policies, procedures, and guidance ("methodologies") for using other auditors. The PCAOB has also observed differences among firms' methodologies, for example, in their approaches to determining whether the firm's participation in an audit is sufficient for the firm to serve as lead auditor.

The PCAOB has also noted through its oversight activities that some audit firms have applied advances in technology to various aspects of the audit, including the supervision of engagement team members and other communications.⁵⁰ The PCAOB has taken these practice developments into account in formulating the amendments.

Observations from Audit Inspections and Enforcement Cases

This section discusses observations based on PCAOB audit inspections and PCAOB and SEC enforcement cases. PCAOB staff has inspected the work of auditors who use other auditors, such as by reviewing the scope of work performed by the other auditor, the planning and instructions provided to the other auditor, and the degree of supervision (including review) of the other auditor. The PCAOB has also inspected the work of other auditors, such as by conducting inspections abroad and reviewing work performed by non-U.S. auditors at the request of a U.S.-based lead auditor. In some cases, PCAOB staff inspected the work performed by both the lead auditor and other auditors on the same audit. In many cases, but not always, the lead

⁵⁰ See PCAOB, *Spotlight: Data and Technology Research Project Update* (May 2020), at 4-5 (noting that some firms have applied technology and developed tools to "improve communications between the auditor and the company or among members of the engagement team (including other auditors), track information received during the audit, automate the documentation of procedures performed, and facilitate the efficiency of supervisory review.").

auditor was a U.S. firm while the other auditor was located in another jurisdiction. In addition, in 2019 the PCAOB established a "target team" of staff who performed inspection procedures across inspected firms. The team focused on U.S.-based multi-location audits and on issuer audits at annually inspected firms in which the U.S. firm was not the lead auditor.⁵¹

Other Auditors

PCAOB inspections staff has observed significant audit deficiencies in the work performed by other auditors, including noncompliance with the lead auditor's instructions and failure to communicate significant accounting and auditing issues to the lead auditor. Deficiencies have also been identified in other auditors' compliance with PCAOB standards governing a variety of audit procedures.⁵²

These failures in audit performance occurred in critical audit areas that are frequently selected for inspection, including revenue, accounts receivable, internal control over financial reporting, and accounting estimates including fair value measurements. For example, in several instances, other auditors failed to perform sufficient procedures in auditing the revenue of a company's business unit, including with respect to evaluating the business unit's revenue recognition policy, testing the occurrence of revenue, and testing the operating effectiveness of the business unit's controls over revenue. In recent years, there have been some indications of decreasing inspection-observed deficiencies, as discussed below.

The Board in its enforcement cases has made similar findings about failures in audit performance. In one case, the Board found that an other auditor failed to perform audit

⁵¹ See PCAOB, Spotlight: Staff Update and Preview of 2019 Inspection Observations (Oct. 8, 2020).

⁵² See, e.g., 2016 Proposal at 16-17.

procedures and to exercise supervisory responsibilities in accordance with PCAOB standards.⁵³

In another case, an other auditor failed to exercise due professional care and failed to obtain sufficient audit evidence for the audit work on accounts receivable.⁵⁴ In a more recent case, other auditors failed to exercise due professional care, respond adequately to a known significant risk, and obtain sufficient appropriate audit evidence, and they misrepresented their work in communications with the lead auditor.⁵⁵

Lead Auditor

Over the years, there have been numerous observations from inspections and from enforcement cases where 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. These failures occurred at large and small firms, domestic and international. Among the most egregious findings, lead auditors failed to perform an audit or participated very little in the audit, and instead issued an audit report on the basis of procedures performed by other auditors.⁵⁶

⁵³ See *In the Matter of Akiyo Yoshida, CPA*, PCAOB Release No. 105-2014-024 (Dec. 17, 2014). Unless otherwise indicated, the enforcement cases discussed in this section were settled proceedings.

⁵⁴ See *In the Matter of Wander Rodrigues Teles*, PCAOB Release No. 105-2017-007 (Mar. 20, 2017).

⁵⁵ See *In the Matter of Ricardo Agustín García Chagoyán, José Ignacio Valle Aparicio, and Rubén Eduardo Guerrero Cervera*, PCAOB Release No. 105-2018-021 (Oct. 30, 2018).

⁵⁶ For findings in PCAOB enforcement cases, see, for example, *In the Matter of Michael T. Studer, CPA, P.C. and Michael T. Studer, CPA*, PCAOB Release No. 105-2012-007 (Sept. 7, 2012), and *In the Matter of Bentleys Brisbane Partnership and Robert John Forbes, CA*, PCAOB Release No. 105-2011-007 (Dec. 20, 2011). Some of the standards violated in the enforcement cases cited in this release were predecessor standards to current PCAOB standards. The descriptions of inspection findings in this release are based on certain accounting firm inspection reports (portions of which are available on the PCAOB's website) and on the PCAOB's experience with inspecting firms.

In these audits, the auditor failed to appropriately determine that it could serve as the lead auditor when all or a substantial portion of the financial statements were audited by another auditor. In two SEC enforcement cases, one firm failed to perform any analysis,⁵⁷ and another firm failed to perform an adequate analysis,⁵⁸ under AS 1205 regarding the sufficiency of its participation to serve as lead auditor.

There also have been findings in which the lead auditor failed to assess, or adequately assess, the qualifications of other auditors' personnel who participated in the audit. For example, PCAOB oversight activities have revealed situations in which the other auditors' personnel lacked the necessary industry experience or knowledge of PCAOB standards and rules (including independence requirements), SEC rules, and the applicable financial reporting framework to perform the work requested by the lead auditor.⁵⁹ Other examples identified through PCAOB and SEC oversight activities include audits in which: (i) the lead auditor failed to ascertain whether the other auditors, each of whom played a substantial role in the audit,⁶⁰ were registered with the PCAOB;⁶¹ (ii) the lead auditor failed to obtain, review, and retain the results of the other

⁵⁷ See *BDO Canada LLP (f/k/a BDO Dunwoody LLP)*, SEC AAER No. 3926 (Mar. 13, 2018).

⁵⁸ See *KPMG Inc.*, SEC AAER No. 3927 (Mar. 13, 2018).

⁵⁹ See, e.g., *In the Matter of Gregory & Associates, LLC, and Alan D. Gregory*, CPA, PCAOB Release No. 105-2019-018 (Aug. 21, 2019).

⁶⁰ See PCAOB Rule 2100, *Registration Requirements for Public Accounting Firms* (providing that any firm that plays a substantial role in the preparation or furnishing of an audit report with respect to any issuer, broker, or dealer must be registered with the Board); see also PCAOB Rule 1001(p)(ii), *Definitions of Terms Employed in Rules* (defining the phrase "play a substantial role in the preparation or furnishing of an audit report").

⁶¹ See, e.g., *BDO Canada LLP*, SEC AAER No. 3926; *KPMG Inc.*, SEC AAER No. 3927.

auditor's procedures relating to risks;⁶² (iii) the lead auditor failed to instruct the other auditor to perform an audit in accordance with PCAOB standards;⁶³ (iv) the lead auditor failed to supervise the other auditors or provide specific instructions to them, including detailed audit plans, appropriate modifications to audit plans based on identified risks, the audit objectives to be accomplished, or the need to maintain proper documentation;⁶⁴ (v) the lead auditor failed to adequately supervise the work of foreign audit staff in circumstances in which the engagement partner did not speak, read, or write the language used by the foreign staff;⁶⁵ and (vi) the lead auditor failed to adequately analyze whether it could serve as the principal auditor, relied on the work of an other auditor that was not registered with the PCAOB, and failed to determine whether the other auditor's work complied with PCAOB auditing standards.⁶⁶ In recent years, there have been indications of increased involvement by some firms in the supervision of other auditors, as discussed below.

⁶² See *In the Matter of Ron Freund, CPA*, PCAOB File No. 105-2009-007 (Jan. 26, 2015), at 1 (Board order summarily affirming hearing officer's finding of violation and imposition of sanction) (finding a violation of AU 543.12b, which was reorganized by the PCAOB in March 2015 as AS 1205.12b, and which required that "the principal auditor must obtain, and review and retain, ... [a] list of significant fraud risk factors, the auditor's response, and the results of the auditor's related procedures").

⁶³ See *BDO Canada LLP*, SEC AAER No. 3926.

⁶⁴ See, e.g., *Anderson Bradshaw PLLC*, Russell Anderson, CPA, Sandra Chen, CPA, and William Denney, CPA, SEC AAER No. 3856 (Jan. 26, 2017); *Sherb & Co., LLP*, Steven J. Sherb, CPA, Christopher A. Valteau, CPA, Mark Mycio, CPA, and Steven N. Epstein, CPA, SEC AAER No. 3512 (Nov. 6, 2013).

⁶⁵ See, e.g., *In the Matter of Acquavella, Chiarelli, Shuster, Berkower & Co., LLP*, PCAOB Release No. 105-2013-010 (Nov. 21, 2013); *In the Matter of David T. Svoboda, CPA*, PCAOB Release No. 105-2013-011 (Nov. 21, 2013).

⁶⁶ See *In the Matter of Morgan & Company LLP*, PCAOB Release No. 105-2021-002 (Mar. 30, 2021).

Divided-Responsibility Audits

As noted above, audits in which the lead auditor divides responsibility with one or more other accounting firms are relatively uncommon.⁶⁷ For example, division of responsibility between auditors might occur for an equity method investment or a late-year acquisition of a company audited by another auditor.

Evolution of Inspection Findings

As noted above, some firms, particularly larger firms affiliated with global networks, have increased their supervision of other auditors in light of other standards. In recent years, some larger U.S. firms have made further changes to their audit methodologies, perhaps in response to deficiencies identified by PCAOB inspections, enforcement cases by regulators, and ongoing rulemaking developments. Specifically, some firms have encouraged a greater level of supervision by the lead auditor, such as frequent comprehensive communications with other auditors and review of other auditors' work papers in the areas of significant risk.

There have been some indications from PCAOB inspections that these firms' revisions to methodologies may have contributed to a decline in inspection-observed audit deficiencies at the firms' foreign affiliates with respect to work performed at the lead auditor's request.⁶⁸ In 2014, for example, PCAOB inspections staff observed a decrease in the number of significant audit deficiencies in work performed by other auditors.⁶⁹ Since 2014, the rate of deficiencies has

⁶⁷ 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 in 2021, 2020, 2019, and 2018 disclosed 36, 41, 37, and 42 divided-responsibility audits, respectively.

⁶⁸ For data regarding deficiencies in audits that involve other auditors, see discussion below.

⁶⁹ See PCAOB, *Staff Inspection Brief: Information about 2017 Inspections*, Vol. 2017/3 (Aug. 2017), at 7. The observed decrease is in comparison to the rate of deficiencies in

fluctuated but remained below the 2013 level. Thus, the changes to the methodologies of some firms appear to have contributed to some improvements in the quality of audits.

In 2019, some of the Board's inspections focused on certain topics in audits involving other auditors, including planning and risk assessment, determining the appropriateness of serving as lead auditor, and communications between the lead auditor and other auditors. The inspectors observed improved audit quality when the lead auditor and other auditors communicated regularly and consistently. They also observed areas for improvement, including the documentation of required procedures, reporting of certain audit participants, and compliance with independence requirements.⁷⁰

Reasons to Improve Auditing Standards

The increasing globalization of business, especially among large public companies, has led to expanded use of other auditors and increasingly significant roles for other auditors within the audit. When other auditors participate in an audit, it is important for investor protection that the engagement partner and, in turn, lead auditor assure that the audit is performed in accordance with PCAOB standards and that sufficient appropriate evidence is obtained through the combined work of the lead auditor and other auditors to support the lead auditor's opinion in the audit report on the company's consolidated financial statements. Among other things, this means

certain inspected work in 2011, 2012, and 2013, when inspections staff, in each year respectively, identified significant audit deficiencies in about 32, 38, and 42 percent of the inspected work performed for lead auditors by non-U.S. members of the six largest global networks. See *Audit Committee Dialogue*, PCAOB Release No. 2015-003 (May 7, 2015), at 9 (graph entitled "Deficiencies in Non-U.S. Referred Work"). Because issuer audit engagements and aspects of those engagements are selected for inspection based on a number of risk-related and other factors, the deficiencies included in inspections reports are not necessarily representative of the inspected firms' issuer audit engagement practice.

⁷⁰ See PCAOB, *Spotlight: Staff Update and Preview of 2019 Inspection Observations* (Oct. 8, 2020), at 5-6.

that the lead auditor should be appropriately involved in the audit so that the work of all audit participants is properly planned and supervised, the results of the work are properly evaluated, and the lead auditor is in a position to conclude that the financial statements are presented fairly in all material respects. Lack of adequate lead auditor planning or supervision can result in deficient audits.

As noted above, some firms have made changes to their audit methodologies regarding the use of other auditors. However, other firms that have not made significant improvements to their methodologies concerning the planning and supervision of audits involving other auditors may have greater risk of lower quality audits when they use other auditors.

Additionally, observations from PCAOB oversight activities indicate that further improvements are needed. PCAOB staff continues to identify deficiencies in the work of other auditors in critical audit areas, deficiencies that lead auditors had not identified or sufficiently addressed. In some cases, these deficiencies occurred even when lead auditors did not violate existing requirements related to the use of other auditors, for example, if the lead auditor performed the procedures described in AS 1205 but did not identify these deficiencies. Such findings indicate that investor protection could be improved by, among other things, increased involvement in, and evaluation of, the work of other auditors by the lead auditor.

Areas for Improvement

To enhance audit practice among all firms using other auditors, the Board identified the following areas for improvement in the current standards:

- *Applying a risk-based supervisory approach.* Applying a risk-based supervisory approach to the lead auditor's oversight of other auditors' work should result in more appropriate involvement by the lead auditor in audits involving other auditors.

Unlike the Board's standards for determining the scope of multi-location audit engagements and general supervision of the audit, which require more audit attention to areas of greater risk, the existing standard for using the work of other auditors does not explicitly require the lead auditor to tailor its planning and oversight of other auditors for the associated risks. Applying a risk-based supervisory approach will direct the lead auditor's attention to the areas of greatest risk.

- *Providing additional specificity.* Providing additional specificity for the lead auditor's application of the principles-based supervisory requirements of PCAOB standards to the supervision of other auditors should help address the unique aspects of supervising other auditors. Additional specificity should also help the lead auditor assure that its participation in the audit is sufficient for it to carry out its responsibilities and issue an audit report based on sufficient appropriate evidence.
- *Taking into account recent changes in auditing practice.* Revising PCAOB auditing standards to take into account recent changes that some firms have implemented to make their auditing practices more rigorous for audits that involve other auditors should make those improved practices more uniform across all accounting firms and enable the PCAOB to enforce more rigorous provisions across all firms.

Because of the lead auditor's central role in an audit involving multiple firms, the amendments adopted by the Board seek to strengthen the existing requirements and impose a more uniform approach to the lead auditor's oversight of other auditors' work. These improvements are intended to increase the lead auditor's involvement in and evaluation of the work of other auditors generally, improve communication among the lead auditor and other auditors, enhance the ability of the lead auditor to prevent or detect deficiencies in the work of

other auditors, and thus facilitate improvements in the quality of audits involving other auditors and promote investor protection.

Comments on the Reasons for Standard Setting

A number of commenters on the proposing releases broadly expressed support for enhancing PCAOB standards for using the work of other auditors and referred-to auditors, or stated that the proposed rulemaking would lead to improvements in audit quality. Some of the same commenters and others supported the Board's objective of establishing requirements for overseeing other auditors' work that are risk-based and more closely aligned with the Board's risk assessment standards than the existing standards are. Some commenters supported updating PCAOB standards in light of, among other things, changes in the business environment, company structure, accounting firm and network structure, regulation, and financial reporting, and the increased prevalence of audits involving other auditors. Some other commenters supported providing a more uniform approach to the lead auditor's supervision of other auditors. However, in the view of one commenter, some of the root causes of poor audit performance are not obvious, they have specific effects that are hard to isolate, and not all can be remedied by auditors and the PCAOB.

Although commenters generally supported applying a risk-based approach to the lead auditor's oversight of other auditors' work, some commenters on the proposing releases expressed concerns about certain aspects of the amendments and their economic impact. Some recommended further improvements to the proposed amendments. In the view of some commenters, the amendments should include additional direction in certain areas, be more scalable and better aligned with the risk-based approach, and provide more latitude for the lead auditor to exercise professional judgment, e.g., in determining the nature, timing, and extent of

supervisory activities. The Board's consideration of the comments received is discussed further in this document.

In adopting the amendments, the Board took into account the comments received on the proposing releases. Based on information available to the Board – including the current regulatory baseline, observations from the Board's oversight activities, academic literature, and comments – the Board believes that investors will benefit from strengthened and clarified auditing standards in this area. While the Board does not expect that the revisions to the standards will (or ever could) entirely eliminate audit deficiencies in this area, the revisions will clarify the auditor's responsibilities, align the applicable requirements with the PCAOB's risk-based supervisory standards, and improve the quality of audits.

Overview of Final Rules

The amendments the Board adopted are intended to strengthen the existing requirements and impose a more uniform approach to the lead auditor's supervision of other auditors.⁷¹ As discussed in more detail in this document, they are designed to increase the lead auditor's involvement in, and evaluation of, the work of other auditors, enhance the lead auditor's ability to prevent or detect deficiencies in the work of other auditors, and facilitate improvements in the quality of the work of other auditors. In addition, the Board adopted a new auditing standard that will apply when the lead auditor divides responsibility for an audit with another accounting firm. The key aspects of the amendments and new standard include:

⁷¹ The amendments apply to audits of issuers, as defined in Section 2(a)(7) of Sarbanes-Oxley, 15 U.S.C. 7201(7), and also to audits of brokers and dealers, as defined in Sections 110(3) and (4) of Sarbanes-Oxley, 15 U.S.C. 7220(3)–(4).

- Planning the audit. AS 2101, *Audit Planning*, as amended⁷² will provide that:
 - In audits involving 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.⁷³ The amendments also describe considerations for making the sufficiency determination.

(AS 2101.06A)

- In audits involving referred-to auditors, the Board has established that participation of the engagement partner's firm is ordinarily not sufficient for it to serve as lead auditor if more than 50 percent of the assets or revenues are audited by referred-to auditors. (AS 2101.06A)
- Another amended PCAOB standard, AS 1220, *Engagement Quality Review*, will expressly require that the engagement quality reviewer for the audit review the engagement partner's determination about the sufficiency of his or her firm's participation in the audit to serve as lead auditor. (AS 1220.10a)

⁷² The amendments to AS 2101 and AS 1201 appear in the main body of each standard and in Appendix A of AS 2101. As originally proposed, most of the amendments to these standards would have appeared in a new Appendix B of each standard. As adopted, the provisions that would have appeared in Appendix B are instead integrated in the main body of the standards. *See* 2021 SRC at 9.

⁷³ Under the amended standard, in an integrated audit of financial statements and internal control over financial reporting ("ICFR"), the lead auditor's participation in the audit of ICFR must also be sufficient to provide a basis for it to serve as the lead auditor of ICFR. (AS 2101.06C)

- In audits that involve work performed by other auditors regarding locations or business units, the lead auditor's involvement (through planning and performing audit procedures and supervising other auditors) should be commensurate with the risks of material misstatement associated with those locations or business units. (AS 2101.06B)
- When determining the engagement's compliance with independence and ethics requirements in audits involving other auditors, the lead auditor should:
 - Understand the other auditor's knowledge of SEC independence requirements and PCAOB independence and ethics requirements ("independence and ethics requirements"), and experience in applying the requirements. (AS 2101.06Da)
 - Obtain and review written affirmations⁷⁴ regarding (1) the other auditor's policies and procedures regarding independence and ethics requirements and, if there are none, a description of how it determines its compliance; (2) the other auditor's compliance with independence and ethics requirements, which also describe the nature of any instances of non-compliance; and (3) a description of all relationships between the other auditor and the audit client or persons in financial reporting oversight roles that may reasonably be thought to bear on independence. (AS 2101.06Db)

⁷⁴ The terms "obtain," "retain," "written," or "in writing" do not mandate that documents related to the audit be paper-based. *See* paragraph .04 of AS 1215, *Audit Documentation* (audit documentation may be in the form of paper, electronic files, or other media).

- Inform the other auditor of changes that affect determining compliance with independence and ethics requirements and are relevant to the other auditor's affirmations and descriptions. (AS 2101.06Dc(1))
- Request that the other auditor update its affirmations and descriptions to reflect any changes in circumstances. (AS 2101.06Dc(2))
- If the other auditor would play a substantial role in the audit,⁷⁵ the lead auditor may use the other auditor only if the other auditor is registered with the PCAOB. (AS 2101.06G)
- With respect to the other auditor's knowledge, skill, and ability, the lead auditor should:
 - Understand the knowledge, skill, and ability of the other auditor's engagement team members who assist the lead auditor with planning and supervision. (AS 2101.06Ha)
 - Obtain a written affirmation from the other auditor that its engagement team members possess the knowledge, skill, and ability to perform the assigned tasks. (AS 2101.06Hb)
 - Determine that it can communicate with other auditors and gain access to their audit documentation. (AS 2101.06Hc)
- In multi-tiered audits, a first other auditor may assist the lead auditor in performing procedures with respect to second other auditors concerning

⁷⁵ See PCAOB Rule 1001(p)(ii) (defining the phrase "play a substantial role in the preparation or furnishing of an audit report"), including conforming amendments for the term "lead auditor" as revised in this document.

independence and ethics requirements; the knowledge, skill, and ability of the second other auditors; and communications with second other auditors.

(AS 2101.06E, .06I)

- Supervising the audit. AS 1201, *Supervision of the Audit Engagement*, as amended will require that the lead auditor:
 - Supervise other auditors under the Board's standard on supervision of the audit engagement (AS 1201) when the lead auditor assumes responsibility for the other auditor's work (i.e., does not divide responsibility for the audit with an other auditor).⁷⁶
 - Inform other auditors of the scope of their work and the following items with respect to the work requested to be performed: identified risks of material misstatement associated with the location or business unit, tolerable misstatement, and the amount (if determined) below which misstatements are clearly trivial and do not need to be accumulated. (AS 1201.08)
 - Obtain and review the other auditor's written description of procedures to be performed and discuss with, and communicate in writing to, the other auditor any needed changes to the planned procedures. (AS 1201.09–.10)
 - Obtain and review a written affirmation from the other auditor as to whether the other auditor has performed work in accordance with the lead auditor's

⁷⁶ The work of engaged assistants from outside the firm (e.g., leased staff, secondees, staff from a shared service center) will be governed by the same standards that apply to the work of assistants inside the firm (e.g., firm partners, shareholders, employees), including the supervision provisions in AS 1201.05–.06. *See, e.g.*, Staff Audit Practice Alert No. 6, at 7–11 (July 12, 2010) (discussing engaging assistants from outside the firm).

instructions, and, if the other auditor has not performed such work, 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.

(AS 1201.11)

- Direct other auditors to provide specified documentation concerning work performed.⁷⁷ (AS 1201.12)
- Determine whether the other auditor performed the work as instructed and whether additional audit evidence needs to be obtained. (AS 1201.13)
- Evaluate, in a multi-tiered audit where the lead auditor seeks assistance from a first other auditor to perform any of the above responsibilities with respect to second other auditors,⁷⁸ the first other auditor's supervision of second other auditors. (AS 1201.14)
- Dividing responsibility for the audit. When the lead auditor divides responsibility for the audit with another accounting firm, new auditing standard AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*, will provide that:
 - The lead auditor should determine that audit procedures are performed to test and evaluate the consolidation or combination of the financial statements of

⁷⁷ Under PCAOB standards, the lead auditor's necessary extent of review of the other auditors' documentation depends on the necessary extent of supervision by the lead auditor (*see* AS 1201.06). The documentation to be reviewed by the lead auditor should include, at a minimum, the documentation described in AS 1215.19.

⁷⁸ For a more detailed discussion of multi-tiered audits, see discussion below.

the business units audited by the referred-to auditor into the company's financial statements. (AS 1206.03)

- The lead auditor should communicate in writing to the referred-to auditor the plan to divide responsibility for the audit. (AS 1206.04)
- The lead auditor should obtain written representation from the referred-to auditor that it is independent under PCAOB and SEC requirements and duly licensed to practice. (AS 1206.05)
- The lead auditor may divide responsibility for the audit with a referred-to auditor only if:
 - The referred-to auditor represents it performed its audit and issued its report in accordance with PCAOB standards;
 - The lead auditor determines that the referred-to auditor is familiar with the relevant financial reporting requirements and PCAOB standards;
 - The referred-to auditor is registered with the PCAOB if it played a substantial role in the audit or its report is with respect to a business unit that is itself an issuer, broker, or dealer;
 - In case of the conversion of business unit financial statements from another financial reporting framework to the financial reporting framework of the company, the lead auditor or the referred-to auditor audits the conversion adjustments, and the lead auditor indicates in its report which auditor was responsible for that. (AS 1206.06)
- In situations where the lead auditor is unable to divide responsibility, the lead auditor should: plan and perform procedures necessary to issue an auditor's

report that expresses an opinion; qualify or disclaim an opinion; or withdraw from the engagement. (AS 1206.07)

- The lead auditor's audit report must indicate clearly the division of responsibility, identify the referred-to auditor by name and refer to its report, and disclose the magnitude of the portion of the financial statements (or internal controls over financial reporting) audited by the referred-to auditor. (AS 1206.08)
 - If the referred-to auditor's report is not a standard (i.e., unqualified) report, the lead auditor should make reference to the departure, unless the matter is clearly trivial to the financial statements. (AS 1206.09)
- Additional amendments. The amendments the Board adopted also:
 - Rescind AS 1205, *Part of the Audit Performed by Other Independent Auditors*.
 - This change, in effect, requires lead auditors to supervise (directly or through other auditors) work performed by other auditors under AS 1201 in all cases, unless the lead auditor divides responsibility for the audit with another (referred-to) auditor, in which case AS 1206 applies.
 - Revise AS 1015, *Due Professional Care in the Performance of Work*, to emphasize that other auditors are responsible for performing their work with due professional care.
 - Revise AS 1215 to expressly state that, in an audit involving other auditors, an other auditor must retain documentation of the work that it performs, and that

its documentation is subject to the requirements related to subsequent modification.

- 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.
- Include definitions of key terms "engagement team," "lead auditor," "other auditor," and "referred-to auditor" in AS 2101.
- Revise other PCAOB standards and rules to conform to these amendments.

ADDITIONAL DISCUSSION OF THE AMENDMENTS AND NEW STANDARD

Introduction

The changes to PCAOB standards the Board adopted were intended to improve the quality of audits that involve one or more public accounting firms, and accountants at those firms, that are outside the accounting firm issuing the auditor's report. This section discusses in more detail amendments to auditing standards and a new auditing standard adopted by the Board relating to the use of other auditors and dividing responsibility for the audit with another accounting firm (collectively, "amendments" or "final amendments"). The Board adopted these amendments after taking into account public comments that were received on the requirements proposed in 2016 and in response to supplemental requests for comment issued in 2017 and 2021 as discussed in more detail below in connection with the amendments.

In brief, the amendments include:

- Amendments to AS 1015, *Due Professional Care in the Performance of Work*; AS 1105, *Audit Evidence*; AS 1201, *Supervision of the Audit Engagement*; AS 1215, *Audit Documentation*; AS 1220, *Engagement Quality Review*; and AS 2101, *Audit Planning*;
- A new auditing standard, AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*, for situations in which the accounting firm issuing the auditor's report divides responsibility for the audit with another accounting firm; and
- Other related amendments to PCAOB auditing standards.

In general, the amendments extend the risk-based supervision requirements of PCAOB auditing standards to all situations in which other auditors participate in an audit, unless the lead auditor divides responsibility for the audit with another auditor.⁷⁹ The amendments also strengthen the requirements and provide additional direction to the lead auditor about its responsibilities. For the relatively infrequent situations when the lead auditor divides responsibility for the audit with another auditor, the amendments strengthen the existing approach under PCAOB standards.

The amendments also rescind AS 1205, *Part of the Audit Performed by Other Independent Auditors*, and AI 10, *Part of the Audit Performed by Other Independent Auditors: Auditing Interpretations of AS 1205*.

The amendments to AS 1201 and AS 2101 appear in the main body of each standard and in Appendix A of AS 2101. As originally proposed, most of the amendments to these standards would have appeared in a new Appendix B of each standard. As proposed in the 2021 SRC, the

⁷⁹ For situations involving auditors of the financial statements of the company's investees, see discussion below.

provisions that would have appeared in Appendix B were instead relocated to the body of the two standards (AS 1201 and AS 2101) to enhance the readability and usability of the amendments and to better facilitate their implementation. One commenter on the 2021 SRC commended the PCAOB for relocating the amendments from Appendix B of each standard to the body of the standards, stating that it improves usability and clarity.

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

See paragraphs .A3–.A6 of AS 2101

To operationalize the requirements included in this release, the amendments define the terms "engagement team," "lead auditor," "other auditor," and "referred-to auditor," as discussed below. A commenter on the 2021 SRC recommended alignment of the terminology used in the PCAOB's standards with that of the International Auditing and Assurance Standards Board ("IAASB") and the American Institute of Certified Public Accountants Auditing Standards Board ("ASB"). After considering the comment, the Board adopted the definitions substantially as proposed, because they are designed for the requirements of this rulemaking, which differ from those in the analogous IAASB and ASB standards. These definitions are included in Appendix A of AS 2101 and referenced in other PCAOB standards, where applicable.

Definition of "Engagement Team"

See paragraph .A3 of AS 2101

Under existing PCAOB standards, the engagement partner is responsible for the engagement and its performance, including the proper supervision of the work of engagement team members and for compliance with PCAOB standards.⁸⁰ The term "engagement team" is commonly used in PCAOB auditing standards but has not been defined. The definition of

⁸⁰ See AS 1201.03.

"engagement team" that the Board adopted in AS 2101 will apply to AS 1201 and AS 2101, as amended, and to the new standard, AS 1206. The term specifies, for example, the persons subject to the lead auditor's supervision under AS 1201, which standard will now apply to the relationship between the lead auditor and all other auditors for whose work the lead auditor assumes responsibility, including those currently covered by rescinded AS 1205.

The Board adopted a revised definition to conform to previous amendments to the Board's standards and to address 2021 SRC comments received. 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 2018.⁸¹ As revised, the definition of "engagement team" includes:

- (1) Partners, principals, and shareholders of, and accountants⁸² 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, in connection with the audit, (i) are employed by the lead auditor or an other auditor participating in the audit and (ii) assist that auditor in obtaining

⁸¹ See Amendments to Auditing Standards for Auditor's Use of the Work of Specialists, PCAOB Release No. 2018-006 (Dec. 20, 2018).

⁸² See paragraph (a)(ii) of 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 AS 2101.A3.)

or evaluating audit evidence with respect to a relevant assertion of a significant account or disclosure.⁸³

The definition excludes:

- (1) The engagement quality reviewer and those assisting the reviewer (to which AS 1220 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; and
- (3) Engaged specialists.⁸⁴

In general, the engagement team, as defined, encompasses the engagement partner and individual accountants who perform procedures to obtain and evaluate audit evidence, as well as specialists employed by one of the participating audit firms who perform audit procedures. The following table illustrates the distinction between engagement team members and parties who are not engagement team members under the definition the Board adopted.

Examples of Engagement Team Members	Examples of Parties Who are NOT Engagement Team Members
<ul style="list-style-type: none"> • Engagement partner 	<ul style="list-style-type: none"> • Auditor-engaged specialists⁸⁶

⁸³ The final amendments add the phrase "in connection with the audit" and replace "assist their firm" with "assist that auditor" for clarity.

⁸⁴ 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 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 AS 2101.A3.)

⁸⁶ See AS 1210.

Examples of Engagement Team Members	Examples of Parties Who are NOT Engagement Team Members
<ul style="list-style-type: none"> Personnel from the engagement partner's firm⁸⁵ who perform audit procedures on the audit 	<ul style="list-style-type: none"> Engagement quality reviewer and those assisting the reviewer⁸⁷ Appendix K or filing reviewer⁸⁸ Service auditors of a third-party service organization⁸⁹
<ul style="list-style-type: none"> Personnel of accounting firms and individual accountants outside the engagement partner's firm who perform audit procedures on the audit (supervised under AS 1201)⁹⁰ A firm professional in the national office or centralized group in the firm (including within the firm's network) who performs audit procedures on the audit or assists in planning or supervising the audit 	<ul style="list-style-type: none"> A firm professional who performs a contemporaneous quality control function (e.g., internal inspection or quality control review) but does not perform audit procedures or help plan or supervise the audit work

⁸⁵ The term "engagement partner's firm" is used in this rulemaking to describe the registered public accounting firm issuing the auditor's report. (See first note to AS 2101.A4.)

⁸⁷ AS 1220 applies to those persons.

⁸⁸ Reviewers under Appendix K of SEC Practice Section ("SECPS") Section 1000.45, *SECPS Member Firms with Foreign Associated Firms That Audit SEC Registrants*, 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.

⁸⁹ AS 2601, *Consideration of an Entity's Use of a Service Organization*, sets forth the auditor's responsibilities with respect to using the work of service auditors who issue reports on the controls of a third-party service organization.

⁹⁰ This includes personnel of accounting firms described in rescinded AS 1205 as other auditors for whose work the "principal auditor" (which is the term used in AS 1205) assumes responsibility. By including these individuals in the engagement team, the amendments expand the lead auditor's responsibility to apply the risk-based supervision approach to all accounting firms involved in the audit, except in situations in which the lead auditor divides responsibility for the audit with another accounting firm. (If the lead auditor divides responsibility for the audit with another accounting firm, that firm is considered a referred-to auditor under AS 1206.)

Examples of Engagement Team Members	Examples of Parties Who are NOT Engagement Team Members
	<ul style="list-style-type: none"> • Individuals employed or engaged by the company being audited, such as a company's internal auditors, a company's specialists, and a company's consultants⁹¹

A commenter on the 2021 SRC asked whether the Board considered the potential ramifications of the difference between the proposed definition of "engagement team" and the analogous term "audit engagement team" in SEC independence requirements. One commenter acknowledged that the Board addressed this question in the 2016 Proposal and recommended that the Board add an explanatory footnote to the rule text in the definition of "engagement team."

The Board purposely adopted a definition of "engagement team" that is narrower than the definition of "audit engagement team" in the SEC's independence rules. *See* Rule 2–01(f)(7)(i) of Regulation S-X, 17 CFR 210.2–01(f)(7)(i). In addition to the individuals within the Board's definition of "engagement team," the definition in SEC Rule 2–01(f)(7)(i) also encompasses certain individuals who are not included in the Board's definition, such as the engagement quality reviewer. The Board noted that neither the definition of "engagement team" nor any other amendments in this release affect the definitions within, or the applicability of, the independence requirements of the SEC.

⁹¹ Because of their roles at the company, the work of individuals employed or engaged by the company is not subject to supervision under AS 1201; they are not considered members of the engagement team under the adopted definition. PCAOB standards include requirements regarding the auditor's use of work performed by some of these individuals. *See, e.g.,* AS 1105, Appendix A; AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*; AS 2605, *Consideration of the Internal Audit Function*.

Another commenter expressed concern that the definition of "engagement team" for purposes of AS 2101, AS 1201, and AS 1206 could have implications for other standards. This commenter cited other auditing standards outside of these three standards that use the term "engagement team" and encouraged the PCAOB to revisit these instances to determine the implications for those standards of the new definition. The Board noted that, although the definition is not repeated across all other PCAOB standards, the term "engagement team" in other PCAOB standards has the same meaning as the defined term in AS 2101.A3.⁹²

Finally, a couple of commenters recommended clarifying the definition of "engagement team" with respect to auditor-employed specialists. One commenter suggested specifying that auditor-employed specialists can be engagement team members only if they participate in the audit, while the other suggested changing the proposed reference to "their firm" to instead employ the defined terms "lead auditor" and "other auditor." The Board made corresponding clarifying edits to subparagraph (2) of the definition. Apart from making these changes and certain minor clarifying edits, the Board adopted the definition of "engagement team" as proposed in the 2021 SRC.

Definition of "Lead Auditor"

See paragraph .A4 of AS 2101

The amendments introduce the new term "lead auditor" for both types of scenarios addressed by this rulemaking: supervising other auditors' work under AS 1201, and dividing responsibility for the audit with another accounting firm under AS 1206.⁹³ The term "lead

⁹² See proposed rule text for further amendments made to PCAOB standards in order to clarify that the term "engagement team" has the same meaning (or, where applicable, analogous meaning) as the defined term in AS 2101.A3.

⁹³ The amendments rescind AS 1205, which uses the term "principal auditor."

auditor" replaces the term "principal auditor" that is currently used in several PCAOB standards.⁹⁴ Under the amendments, the term "lead auditor" means the firm issuing the auditor's report, the engagement partner of that firm, and other personnel of that firm (or their functional equivalents) who perform planning or supervisory responsibilities from that firm.

The definition is key to this rulemaking because it identifies the firm and individuals who are responsible for carrying out the requirements under the amendments:

Lead auditor –

- (a) The registered public accounting firm⁹⁵ 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 1201.⁹⁶

⁹⁴ See Other Related Amendments to PCAOB Auditing Standards.

⁹⁵ See paragraph (r)(i) of PCAOB Rule 1001, which defines the term "registered public accounting firm." This footnote is included within the definition appearing in AS 2101.A4.

⁹⁶ 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 AS 1015.06, according to which "[e]ngagement team members should

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 secondees⁹⁷ 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.

Several commenters on the 2021 SRC indicated that the definition of "lead auditor" was sufficiently clear. One commenter on the 2021 SRC stated there was lack of clarity about the use of the term "lead auditor" in circumstances when the audit does not involve other auditors or referred-to auditors. This commenter suggested that the proposed standard explicitly acknowledge either: (1) the registered public accounting firm that issues the auditor's report is always the lead auditor, including when there are no other auditors or referred-to auditors or (2) the registered public accounting firm that issues the auditor's report is only a lead auditor if the audit involves other auditors or referred-to auditors (and therefore modifications would need to be made to the definition of engagement team).

In the proposing releases, the Board stated that the term "lead auditor" would apply to these scenarios: supervising other auditors under AS 1201 and dividing responsibility for the

be assigned to tasks and supervised commensurate with their level of knowledge, skill, and ability." This footnote is included within the definition appearing in AS 2101.A4.

⁹⁷ For this purpose, the term "secondee" refers to an individual participating in a secondment arrangement in which, for at least three consecutive months, (1) a professional employee of an accounting firm in one country works for a registered public accounting firm that is located in another country and is issuing an auditor's report, and (2) the professional employee performs audit procedures with respect to entities and their operations in that other country and does not perform more than de minimis audit procedures in relation to entities or business operations in the country of his or her employer. A secondee can be either physically located in that other country or working through a remote work arrangement. This footnote is included within the definition appearing in AS 2101.A4.

audit under proposed AS 1206. In addition, the amendments already clearly indicate that the term will apply when other auditors or referred-to auditors are involved in the audit.⁹⁸

The description of "secondee" was added to the proposed amendments in the 2021 SRC.⁹⁹ Several commenters said that the description was too prescriptive, given the flexibility in location where audit professionals may work, as demonstrated throughout the COVID-19 pandemic. Most of these commenters were supportive of its inclusion as an example in the rule text, but recommended that "secondee" not be defined so narrowly. They also suggested that individuals who work at shared service centers be included as an example in the rule text given the continued increase in their use. In addition, one commenter said that it did not agree with the Board that at all times (now and in the future) individuals who work at shared service centers will work under the direction and control of and function as employees of the lead auditor firm.

After considering the comments received, the Board is revising footnote 5 of AS 2101.A4 to be similar to revised Form AP staff guidance¹⁰⁰ on secondees. Those revisions recognized that, because of the recent advances in technology and remote work arrangements, location should not necessarily be a factor in determining whether secondees work under the direction and control of the firm and function as their employees. Further, the Board agrees that under the amendments secondees from other accounting firms and employees of shared service centers who both work under the firm's direction and control (as with other individuals who work in the

⁹⁸ See, e.g., AS 2101.04.

⁹⁹ See 2021 SRC at A1-16 (proposed footnote 5 of AS 2101.A4).

¹⁰⁰ See Staff Guidance, Form AP, Auditor Reporting of Certain Audit Participants, and Related Voluntary Audit Report Disclosure Under AS 3101, The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion (Dec. 17, 2021).

role of firm employees) *and* assist the engagement partner in fulfilling planning or supervisory responsibilities on the audit are part of the lead auditor.

Regarding the comment that individuals at shared service centers would not always function as "employees of the lead auditor's firm," the amendments do not provide that all shared service center staff would function as employees of the lead auditor firm. For example, staff at a shared service center could be working on the audit under the direction and control of an audit firm other than the lead auditor. In that case, the individuals at the shared service center would function as employees of the other auditor, not the lead auditor firm.

The Board considered these comments and determined that the proposed definition of lead auditor is sufficiently clear and, except for the revision to the footnote regarding secondees discussed above, adopted it as proposed in the 2021 SRC.

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

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

Several existing PCAOB standards use the term "other auditor" to encompass any auditors outside the lead auditor that participate in an audit, regardless of whether the lead auditor supervises them under AS 1201, assumes responsibility for their work under AS 1205, or makes reference to them under AS 1205.¹⁰¹ The amendments define two terms: "other auditor," and "referred-to auditor." These definitions are as follows:

Other auditor –

¹⁰¹ For example, AS 1205 uses the term "other auditors" to describe accounting firms whose work the lead auditor uses or with which it divides responsibility for the audit. By contrast, AS 1215.18–.19 uses the term "other auditors" when describing offices of the firm issuing the audit report and other firms participating in the audit.

- (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 units¹⁰² 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.¹⁰³

Several commenters on the 2021 SRC indicated that the definition of "other auditor" was sufficiently clear, and no commenters expressed concern about the definition of "referred-to auditor." Some commenters on the 2016 Proposal asked whether the term "referred-to auditor" is aligned with the term "principal accountant" used by the SEC. The Board noted that the

¹⁰² The term "business units" includes subsidiaries, divisions, branches, components, or investments. This footnote is included within the definition appearing in AS 2101.A6.

¹⁰³ 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. This footnote is included within the definition appearing in AS 2101.A6.

definitions it adopted do not affect the applicability of SEC terms or rules to audits involving other auditors or referred-to auditors, including the definition of "principal accountant."

In addition, one commenter on the 2016 Proposal stated that the only difference between the definitions of other auditor and referred-to auditor appears to be divided responsibility, but noted the definitions are substantially different. The Board notes that these definitions reflect differences in lead auditor responsibilities with respect to the other auditor and referred-to auditor. As noted above, under the amendments, the term "other auditor" encompasses both the individuals participating in the audit and their firm. In contrast, the lead auditor divides responsibility for the audit with the referred-to auditor, which issues the auditor's report on the financial statements (and, if applicable, internal control over financial reporting) of a company's business unit. Thus, the term "referred-to auditor" applies only to the firm because the firm issues an auditor's report in the divided-responsibility situation.

The Board considered the comments and determined that the definitions of "other auditor" and "referred-to auditor" are sufficiently clear and adopted them as proposed in the 2021 SRC.

Planning the Audit

See amendments to AS 2101

In general, the amendments to AS 2101 carry forward and update certain requirements of AS 1205 and include certain procedures to be performed by the lead auditor.

This section discusses planning requirements in AS 2101 for audits in which the lead auditor supervises the work of other auditors in accordance with AS 1201. It also discusses certain planning requirements, which appear in AS 2101, for audits in which the lead auditor

divides responsibility for the audit with referred-to auditors in accordance with AS 1206.¹⁰⁴ This section on planning requirements addresses the following topics:

- Serving as the lead auditor in an audit that involves other auditors or referred-to auditors (determining sufficiency of participation);
- Other auditors' compliance with independence and ethics requirements;
- PCAOB registration status of other auditors;
- Knowledge, skill, and ability of and communications with other auditors; and
- Determining locations or business units at which audit procedures should be performed.

Serving as the Lead Auditor in an Audit that Involves Other Auditors or Referred-to Auditors (Determining Sufficiency of Participation)

See paragraphs .06A–.06C of AS 2101

Under AS 2101 as amended, in audits involving 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. The considerations for determining the sufficiency of the firm's participation apply to audits in which the lead auditor supervises other auditors' work, divides responsibility for the audit with another accounting firm, or both. In contrast, the 50-percent participation threshold (discussed below) applies only to audits in which the lead auditor divides responsibility for the audit with another accounting firm.

¹⁰⁴ In addition, this document discusses requirements for the lead auditor in AS 1206 relating to the referred-to auditor's (1) compliance with the SEC independence and PCAOB independence and ethics requirements, (2) registration pursuant to the rules of the PCAOB, and (3) knowledge of the relevant accounting, auditing, and financial reporting requirements.

Planning is not a discrete phase of an audit, but rather is a continual and iterative process that continues until the completion of the audit.¹⁰⁵ Therefore the engagement partner is expected to revisit his or her determination of the sufficiency of the lead auditor's participation throughout the audit if circumstances change. This may occur, for example, because of changes due to business combinations, divestitures, or other events that could affect the audit plan or allocation of work between the lead auditor and other auditors.

Considerations for Serving as the Lead Auditor

See first paragraph of .06A(a-c) of AS 2101

AS 1205, which is being rescinded, provides that when significant parts of the audit are performed by other auditors ("other auditors" and "referred-to auditors" under the amendments), the principal auditor ("lead auditor" under the amendments) must decide whether the principal auditor's own participation is sufficient to enable it to serve as the principal auditor and issue the auditor's report on the company's financial statements. Under AS 1205.02, when determining whether the firm sufficiently participates in the audit, the principal auditor is required to consider, among other things, (i) the materiality of the portion of the financial statements audited in comparison with the portion audited by other auditors; (ii) the extent of the auditor's knowledge of the overall financial statements; and (iii) the importance of the components audited by the auditor in relation to the enterprise as a whole.

The amendments to AS 2101 strengthen the existing requirement for determining the sufficiency of participation by: (i) extending the determination requirement to *all* audits

¹⁰⁵ See AS 2101.05.

involving other auditors and referred-to auditors,¹⁰⁶ not just audits that have been covered by AS 1205; (ii) imposing the determination requirement specifically on the engagement partner; and (iii) specifying certain considerations, based on risk and other factors, that should be taken into account in making the determination.

In general, the sufficiency requirement is intended to increase the likelihood that the firm issuing the auditor's report (i.e., the lead auditor) meaningfully participates in the audit. The Board believes that compliance with this requirement should benefit all audits involving other auditors and referred-to auditors, not only audits that have been covered by AS 1205. Imposing the sufficiency requirement on the engagement partner is consistent with the engagement partner's existing responsibilities under PCAOB standards for planning the audit¹⁰⁷ and for assigning tasks to and supervising engagement team members.¹⁰⁸

The amendments require that, when making the sufficiency determination, the engagement partner take into account the following, in combination, i.e., the engagement partner should take into account all three considerations:

- *Importance* – The importance of the locations or business units 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;

¹⁰⁶ Below, this document discusses further conditions to be met in order to divide responsibility with another accounting firm.

¹⁰⁷ See AS 2101.03.

¹⁰⁸ See AS 1015.06.

- *Risk* – 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
- *Extent of supervision* – The extent of the engagement partner's firm's supervision of the other auditors' work for portions of the company's financial statements for which the other auditors perform audit procedures.¹⁰⁹

Of these three considerations, only the risk consideration was included in the 2016 Proposal. Although it was intended to encompass both quantitative and qualitative aspects of participation, some commenters on the 2016 Proposal viewed a determination based solely on risk as too narrow, and some viewed it as primarily quantitative. Commenters expressed concern that it might result in denying a firm the ability to serve as lead auditor if it performed procedures only at the corporate headquarters and not at the company's operating units (which were audited by other auditors), even if that firm is otherwise best positioned to serve as lead auditor.

The importance consideration was added in the 2017 SRC, after considering comments received on the 2016 Proposal. The addition was intended to more expressly address circumstances in which the lead auditor audits the locations or business units where the primary financial reporting decisions are made and consolidated financial statements are prepared, even though those locations or business units might not constitute a significant portion of the company's operations.¹¹⁰ A number of commenters on the 2017 SRC commented favorably on

¹⁰⁹ In a multi-tiered audit (*see* AS 1201.14), the consideration regarding extent of supervision applies only to the firm's supervision of a first other auditor and any other auditor that is supervised directly by the firm. *See* discussion of multi-tiered audits below.

¹¹⁰ *See* 2017 SRC at 9.

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 on the 2017 SRC viewed the sufficiency determination based on the two proposed considerations (importance and risk) as too restrictive for certain audits. Examples provided by the commenters included companies with highly dispersed management and financial reporting functions, especially those whose operations, headquarters, and financial reporting functions are primarily outside the company's corporate domicile. Commenters stated that applicable laws and regulations might require that the company's audit report be issued by a firm located in the jurisdiction where the company is domiciled, regardless of how much of the audit is performed by that auditor compared to other auditors. To address this issue, the commenters suggested providing additional considerations for the sufficiency-of-participation determination, including the firm's extent of supervision.

The third consideration (extent of supervision) was added in the 2021 SRC. This addition was designed to allow for a more comprehensive determination of the prospective lead auditor's involvement.

Several commenters on the 2021 SRC generally supported the proposed addition of the consideration related to the extent of the engagement partner's firm's supervision of other auditors' work. Some of these comments also agreed that the sufficiency-of-participation determination by the engagement partner should be a risk-based assessment involving quantitative and qualitative considerations. One commenter on the 2021 SRC stated its understanding that an engagement partner may determine that his or her firm can serve as lead auditor by adjusting the extent of his or her firm's supervision of the other auditors' work to

overcome instances where the other auditors are performing audit procedures for significant parts of the audit. This same commenter said it would be helpful for the Board to acknowledge that an auditor who performs relatively fewer audit procedures on global business units can still be considered the lead auditor based on legal or regulatory requirements and his or her firm's supervision of other auditors.

Other commenters continued to have concerns similar to those expressed in 2017 (e.g., regarding jurisdictional matters) even with the additional consideration. These commenters suggested that the Board provide further considerations, and therefore additional flexibility, for the determination.

The Board believes the three considerations will enable engagement partners to address the multitude of scenarios encountered in practice when determining their firms' sufficiency of participation. With regard to the comments on jurisdictional challenges posed by laws and regulations, if the auditor's report is required to be issued by a firm licensed in a certain jurisdiction, under the amendments that firm could serve as lead auditor (subject to certain conditions such as necessary extent of supervision), even if it does not perform audit procedures on many of the company's subsidiaries. In addition, a firm could obtain additional staff to perform audit procedures under the firm's direction and control functioning as the firm's employees in order to be able to serve as the lead auditor. Adding more considerations, as some commenters suggested, could increase the risk that the firm issuing the auditor's report does not meaningfully participate in the audit, and thus was the "lead auditor" in name only.¹¹¹ Permitting such arrangements would not achieve the intent of the amendments.

¹¹¹ Such arrangements are sometimes referred to as "letterbox audits."

One commenter pointed out that with respect to divided-responsibility situations, the lead auditor often may not be able to fully apply certain considerations (e.g., the concept of "supervision" in AS 2101.06Ac). The Board noted that in a divided-responsibility situation, the overall principles of .06Aa-b are the relevant considerations, because the consideration in .06Ac does not by its terms address referred-to auditors. AS 2101.06Ac states that the "extent of the engagement partner's firm's supervision of the *other auditors'* work for portions of the company's financial statements for which the *other auditors* perform audit procedures" (emphasis added).

After considering the comments received, the Board adopted the requirements substantially as proposed.¹¹² The engagement partner will take into account the three considerations (importance, risk, and supervision) in combination to determine whether the full range of his or her firm's involvement in the audit constitutes sufficient participation to serve as the lead auditor.¹¹³

Fifty-Percent Participation Threshold for Divided-Responsibility Audits

See second paragraph of .06A of AS 2101

For divided-responsibility audits,¹¹⁴ the Board determined to adopt, as proposed, amendments to reflect the following "50-percent threshold," which applies *in addition* to two of

¹¹² Footnote 4B to AS 2101.06Ac has been revised to add the following sentence: "*See also* AS 1201.07, which states that for engagements that involve other auditors, AS 1201.08–.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 AS 1201."

¹¹³ The lead auditor's analysis of its sufficiency of participation should be documented pursuant to AS 1215.06, which requires, among other things, that audit documentation contain sufficient information to enable an experienced auditor, having no previous connection with the engagement, to understand the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached.

¹¹⁴ 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.

the three considerations for determining the sufficiency of participation discussed above (importance and risk):¹¹⁵

[T]he 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.

This 50-percent threshold is intended to reduce the likelihood that the lead auditor divides responsibility with an accounting firm or firms that audit a majority of the company's assets or revenue, and is consistent with the Board's approach to reinforcing the accountability of the lead auditor in audits involving other auditors.¹¹⁶ Including this threshold in the amendments also preserves a longstanding practice of the profession.

One commenter on the 2021 SRC asserted (with respect to the 50-percent threshold for divided-responsibility audits) that a firm's analysis as to whether it can reasonably serve as lead auditor must consider all the facts and circumstances, rather than simply consolidated assets or revenues. Another commenter asked that the wording of the 50-percent threshold be revised when referred-to auditors are involved because there are scenarios in which either assets or revenues audited by the referred-to auditor are greater than the assets or revenues audited by the lead auditor, such as when consolidated revenues of the company overall are nominal, but the

Form AP filings in 2021, 2020, 2019, and 2018 disclosed 36, 41, 37, and 42 divided-responsibility audits, respectively.

¹¹⁵ This release, below, discusses further conditions to be met in order to divide responsibility with another accounting firm.

¹¹⁶ The threshold is similar to a quantitative threshold that appears in staff guidance set forth in the Financial Reporting Manual of the SEC Division of Corporation Finance ("Corp. Fin. Manual"). The Corp. Fin. Manual provides that a lead auditor is generally expected to have audited or assumed responsibility for at least 50 percent of the assets and revenues of the consolidated entity. *See* SEC, Division of Corporation Finance, Financial Reporting Manual, Section 4140.1.

amounts that do exist are audited by the referred-to auditor. This commenter believed that use of the term "or" will allow for false positives and restrict the ability of lead auditors to make reference to referred-to-auditors.

After considering the comments, the Board adopted the 50-percent threshold as proposed. That threshold creates a presumption (not a bright line test) that the lead auditor will not divide responsibility with an accounting firm or firms that audit a majority of the company's assets or revenues.¹¹⁷ A firm could overcome the presumption and serve as lead auditor in exceptional situations, involving, for example, late-year acquisitions or other unanticipated events or conditions that increase the portion of assets or revenues audited by referred-to auditors beyond the 50-percent threshold. Under PCAOB standards, the firm would need to document why its participation in the audit was sufficient to serve as lead auditor, including how the firm satisfied the criteria based on the importance of the locations or business units it audited and risks of material misstatement associated with the portion of the company's financial statements that it audited.

The description of the 50-percent threshold in the amendments differs from the analogous description in the Corp. Fin. Manual because the PCAOB description uses terminology consistent with the amendments (whereas the Corp. Fin. Manual's formulation uses terminology consistent with pre-amendment standards) and because the PCAOB description is written in the negative: "in an audit that involves referred-to auditors ... the participation of the engagement

¹¹⁷ Notably, while the comparison based on the importance of the locations or business units and risks of material misstatement associated with the portion of the financial statements is made singly (i.e., with regard to the engagement partner's firm's participation), the additional threshold based on assets and revenue is made with regard to all referred-to auditors in the aggregate.

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."

Supervising Based on Risk

See paragraph .06B of AS 2101

In some audits, the lead auditor might decide to increase the extent of its supervision of other auditors' work to provide additional support for the sufficiency-of-participation determination. Although this practice would contribute to the lead auditor's participation to some extent, performing additional supervisory procedures with respect to the other auditors does not, by itself, relieve the lead auditor of its own obligation to perform meaningful audit procedures in the audit.

The amendments do not allow an audit firm to serve as lead auditor when all of the audit procedures are performed by other auditors, even under the lead auditor's supervision. A determination to serve as lead auditor under the amendments needs to be supported by a combination of supervision of other auditors by the lead auditor and the lead auditor's performance of audit procedures.

In particular, the Board believes that a lead auditor, as the firm that issues the audit report, should perform audit procedures to a meaningful extent even if the company's business operations and financial reporting functions are located in a different country than the lead auditor. The following are examples¹¹⁸ of such procedures:

¹¹⁸ In addition, the lead auditor would perform audit procedures with respect to locations or business units selected for testing that the lead auditor assigned to itself.

- *Procedures related to risks pervasive to the financial statements*, such as risk assessment procedures directed to risks to the consolidated financial statements as a whole.¹¹⁹
- *Procedures related to the consolidated financial statements*, such as audit procedures regarding the period-end financial reporting process¹²⁰ for the consolidated financial statements, and evaluation of the presentation of the consolidated financial statements, including the disclosures.¹²¹
- *Other procedures related to the overall evaluation of audit results*, such as performing overall analytical review procedures;¹²² evaluating accumulated misstatements;¹²³ evaluating identified control deficiencies;¹²⁴ evaluating the qualitative aspects of the overall financial statements, including potential management bias;¹²⁵ evaluating conditions related to fraud risk assessment;¹²⁶ and evaluating the sufficiency and appropriateness of the audit evidence obtained.¹²⁷

¹¹⁹ See AS 2110.59b.

¹²⁰ See AS 2301.41.

¹²¹ See paragraphs .30–.31 of AS 2810, *Evaluating Audit Results*.

¹²² See AS 2810.07–.09.

¹²³ See AS 2810.10–.23.

¹²⁴ See AS 2201.62–.70.

¹²⁵ See AS 2810.24–.27.

¹²⁶ See AS 2810.28–.29.

¹²⁷ See AS 2810.32–.36.

In these examples, the lead auditor would not need to perform these procedures exclusively. Rather, it could ask other auditors for assistance with some aspects of the above procedures, such as obtaining audit evidence relating to the business units assigned to the other auditors.

In the amendments, AS 2101.06B, which is intended to be a reminder concerning existing requirements, provides 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 requirement draws from existing requirements in AS 1201, AS 2101, and AS 2301, which require greater involvement in areas of greater risk.¹²⁸ No commenters opposed the requirement.

The Board adopted this provision as proposed.

Sufficiency Considerations in an Integrated Audit of Financial Statements and
Internal Control Over Financial Reporting

See paragraph .06C of AS 2101

In the amendments, AS 2101.06C states that in an integrated audit of a company's financial statements and its internal control over financial reporting ("ICFR") that involves other auditors or referred-to auditors, the lead auditor of the financial statements must participate sufficiently in the audit of ICFR to provide a basis for serving as the lead auditor of ICFR. Only

¹²⁸ See footnote 4C of AS 2101.06B, which cites, as examples, AS 1201.06, 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."), and, more generally, AS 2301.

the lead auditor of the financial statements can be the lead auditor of ICFR. This amendment incorporates an existing requirement from AS 2201 regarding the sufficiency of the lead auditor's participation in the integrated audit of financial statements and ICFR.¹²⁹ No commenters objected to this requirement, and the Board adopted it as proposed.

Other Auditors' Compliance with Independence and Ethics Requirements

*See paragraphs .06D and .06F of AS 2101*¹³⁰

The amendments to AS 2101 relating to auditor independence and ethics requirements build on the existing, overarching responsibility of the auditor to determine compliance with independence and ethics requirements.¹³¹ The amendments are designed to position the lead auditor to identify matters that warrant further attention when determining the other auditor's compliance with those requirements. Commenters on the proposing releases generally agreed that the lead auditor should perform procedures regarding other auditors' compliance with these requirements. Several commenters, however, raised questions about specific aspects of the provisions, which are discussed below.

¹²⁹ See conforming amendments to AS 2201.C8, .C10, and .C11. The terminology in these paragraphs has been updated to align with the amendments, without changing the intent of the requirements in these paragraphs.

¹³⁰ See discussion below 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 AS 1206 for requirements relating to audits involving referred-to auditors.

¹³¹ See AS 2101.06b (requiring the auditor to "[d]etermine compliance with independence and ethics requirements" at the beginning of the audit and to reevaluate the determination throughout the audit). As noted above, the use of "independence and ethics requirements" in this release refers to PCAOB independence and ethics requirements and SEC independence requirements.

Understanding the Other Auditor's Knowledge and Experience; Obtaining an
Affirmation about Policies and Procedures, Changes in Circumstances

See paragraphs .06Da, .06Db(1), and .06Dc(1) – (2) of AS 2101

The Board adopted the amendments discussed in this section as they were proposed in the 2021 SRC. The amendments in AS 2101.06D require the lead auditor to perform certain procedures "in conjunction with determining compliance with" independence and ethics requirements, to carry out its responsibilities pursuant to the existing requirements in paragraph .06b of AS 2101.

AS 2101.06Da requires that the lead auditor obtain an understanding of the other auditor's knowledge of independence and ethics requirements and its experience in applying the requirements. AS 2101.06Db(1) requires that the lead auditor obtain from the other auditor and review a written affirmation¹³² 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 is 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.

The amendments require 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

¹³² The final 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., AS 1206*).

documents to the lead auditor upon becoming aware of such changes.¹³³ These amendments are meant to provide the lead auditor with information necessary for it to reevaluate compliance with independence and ethics requirements.¹³⁴ Communications required by the amendments also reflect policies already adopted by a number of registered firms.

The Board notes that the nature and extent of the lead auditor's procedures for obtaining an understanding under paragraph .06Da will depend on the types of information available to the lead auditor about the other auditor. The following are examples of types of information that may be relevant to the lead auditor's understanding of the other auditor's knowledge of independence and ethics requirements, and the other auditor's experience in applying the requirements:

- The type, frequency, and substance of independence and ethics training that the other auditor provides to its personnel who participate in the audit;
- The other auditor's policies and procedures for ensuring that the firm and its personnel comply with independence and ethics requirements, including PCAOB Rule 3520, *Auditor Independence*,¹³⁵

¹³³ See AS 2101.06Dc, which applies to all affirmations and descriptions required by paragraph .06Db.

¹³⁴ See note to AS 2101.06b regarding reevaluating compliance.

¹³⁵ See also QC 20, System of Quality Control for a CPA Firm's Accounting and Auditing Practice.

- The other auditor's process for determining that the other auditor, including the firm and its applicable personnel, does not have financial or employment relationships that might impair the lead auditor's independence on the audit;¹³⁶
- The other auditor's process for obtaining timely information about the audit client and its affiliates from which the other auditor firm is required to maintain independence, including an understanding of all non-audit services initiated or about to be initiated for the audit client by the other auditor;¹³⁷ and
- Any business relationships between the other auditor (including the firm and its applicable personnel) and the audit client, or persons associated with the audit client in a decision-making capacity, such as officers, directors, or substantial stockholders.¹³⁸

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 their 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.

¹³⁶ See Rules 2-01(c)(1) and 2-01(c)(2) of Regulation S-X, 17 CFR 210.2-01(c)(1) and 17 CFR 210.2-01(c)(2).

¹³⁷ PCAOB and SEC independence rules define "affiliate of the audit client." See PCAOB Rule 3501(a)(ii); Rule 2-01(f)(4) of Regulation S-X, 17 CFR 210.2-01(f)(4). For rules regarding the prohibition of non-audit services, see Rules 2-01(c)(4) and 2-01(b) of Regulation S-X, 17 CFR 210.2-01(c)(4) and 17 CFR 210.2-01(b); PCAOB Rule 3522, *Tax Transactions*; and PCAOB Rule 3523, *Tax Services for Persons in Financial Reporting Oversight Roles*. See also PCAOB Rule 3521, *Contingent Fees*.

¹³⁸ See Rule 2-01(c)(3) of Regulation S-X, 17 CFR 210.2-01(c)(3).

Commenters on the 2021 SRC generally supported the modifications made to proposed AS 2101.06D, including the requirement to obtain written affirmations from the other auditor about whether the other auditor's policies and procedures provide reasonable assurance of compliance with independence and ethics, and whether the other auditor is in compliance. However, some commenters asked the Board to modify the requirements for the written affirmation and noted that a firm's quality control assessment with respect to independence is done on an annual basis. These commenters recommended that the Board align the amendments in this rulemaking with those of the PCAOB's project regarding quality control standards.¹³⁹ In the view of one of these commenters, it was not the Board's intention to require the other auditor engagement team members to make their own conclusion about an aspect of their firm's quality control system relative to a particular engagement.

Even in circumstances when other auditor engagement team members rely on their firm's quality control system for independence and ethics compliance, the Board believes it is appropriate to require the lead auditor to request and obtain in the context of an audit an affirmation that the other auditor's firm has the necessary policies and procedures. In practice, audit engagement teams typically exchange information with their own firm's quality control function relating to compliance with certain independence and ethics requirements. However, if an other auditor does not have policies and procedures that provide reasonable assurance that it complies with such requirements, it is appropriate to require that the lead auditor request and obtain a description of how the other auditor determines its compliance with the independence and ethics requirements. The Board believes that this requirement is appropriate today and will

¹³⁹ Concept Release: Potential Approach to Revisions to PCAOB Quality Control Standards, PCAOB Release No. 2019-003 (Dec. 17, 2019).

remain appropriate after firms implement the IAASB's newly adopted International Standard on Quality Management 1 ("ISQM 1"), which will require firms that perform audits under IAASB standards to evaluate the effectiveness of its quality control system, or under PCAOB standards if the Board were to adopt a similar requirement.¹⁴⁰

In addition, a couple of commenters suggested requiring that the lead auditor make the other auditor aware of PCAOB and SEC independence requirements that are relevant to the company.

The requirement for the lead auditor to obtain an understanding (pursuant to paragraph .06Da) is designed to assist the lead auditor in determining its course of action regarding the other auditor's independence and ethics compliance. For example, other auditors with less knowledge and experience may be less able to provide the information the lead auditor needs to determine compliance with independence and ethics requirements. The lead auditor may need to communicate PCAOB and SEC independence requirements to some other auditors (e.g., those who are less familiar with the requirements) but not to others (e.g., those who are more familiar with the requirements). The Board believes the amendments are sufficiently principles-based to allow the lead auditor to adjust its procedures according to the circumstances of the audit, including with respect to:

- Making other auditors aware of the relevant independence and ethics requirements for the audit engagement, including affirming compliance not only with respect to their audit client, but also with respect to any affiliates of that audit client;

¹⁴⁰ The IAASB adopted ISQM 1 in December 2020, and it will become effective on December 15, 2022. *See* IAASB, ISQM 1, Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements (Dec. 17, 2020).

- Confirming that the other auditors understand the requirements; and
- Considering whether additional information for other auditors is necessary regarding the independence and ethics requirements that are relevant to the audit engagement.

With respect to AS 2101.06Dc(1) – (2), one commenter stated that it is not necessary for other auditors to reaffirm in writing every update that is communicated by the lead auditor. The Board believes that an informative record of relevant matters is important for determining compliance with independence and ethics requirements. Auditor independence is critical for an effective audit; lack of independence can compromise the effectiveness of audit procedures performed by the other auditor. The amendments are designed to provide the lead auditor with timely information indicating that the other auditor's independence may be compromised, thus enabling the lead auditor to take any necessary action during the course of the audit.

Obtaining a Written Description of the Other Auditor's Covered Relationships

See paragraph .06Db(2) of AS 2101

Under the 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 client¹⁴¹ 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.*¹⁴² The requirement is

¹⁴¹ 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." The terms used in AS 2101.06Db(2) have the same meaning as defined in Rule 3501.

¹⁴² Rule 3526 requires auditors 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*

designed to assist the lead auditor in obtaining information for determining compliance with SEC and PCAOB independence requirements and to facilitate auditor communications to the audit committee under Rule 3526. The amendments do not change the applicability of Rule 3526 to the lead auditor's representation, *including* with respect to unaffiliated firms.¹⁴³

One commenter supported the proposed requirement, noting that PCAOB Rule 3526 requires communication only from the lead auditor to the audit committee. The commenter added that the proposed new requirement – with respect to the lead auditor determining an other auditor's compliance with independence and ethics requirements rather than simply inquiring about it (e.g., under extant AS 1205) – aligns the responsibility to make such determination better with the required communication.

No commenters opposed this requirement, and the Board adopted it as proposed.

Obtaining a Written Affirmation about the Other Auditor's Compliance with
Independence and Ethics Requirements

See paragraph .06Db(3) of AS 2101

Under the 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, the lead auditor should obtain and review a written description of the nature of the instances of non-compliance.

Committees Concerning Independence (May 31, 2019), which addresses questions that have arisen in practice regarding application of Rule 3526(b) in certain circumstances.

¹⁴³ See *Ethics and Independence Rule 3526, Communication with Audit Committees Concerning Independence*, PCAOB Release No. 2008-003 (Apr. 22, 2008), at 5 note 4, which states that the Board "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" (emphasis added).

This requirement was originally introduced in the 2016 Proposal, to strengthen a requirement in AS 1205, which is being rescinded, to make inquiries concerning the other auditor's independence.¹⁴⁴ This provision was revised and clarified in the amendments proposed in the 2017 and 2021 SRCs to require in addition that the lead auditor obtain and review a description of the nature of the instances of any non-compliance.

One commenter on the 2021 SRC recommended that the Board modify the proposed requirement to also include the other auditor's conclusion regarding whether it is capable of exercising objective and impartial judgment on all issues encompassed in its work. In response, the Board noted that the lead auditor can determine its course of action based on the facts and circumstances of the audit engagement, without the Board prescribing a course of action in the amendments. Therefore, the Board did not make additional changes to this requirement and adopted it as proposed.

Following Up on Contrary Information

See paragraph .06F of AS 2101

The amendments to AS 2101 direct the lead auditor to follow up on contrary information. The amendments provide that if the lead auditor becomes aware of information that contradicts the other auditor's affirmation or description (including information about changed circumstances), the lead auditor should investigate the circumstances and consider the reliability of the affirmation or description. Further, if, after such investigation, or based on the other auditor's affirmation or description, there are indications that the other auditor is not in compliance with independence and ethics requirements, the lead auditor should consider the

¹⁴⁴ *See AS 1205.10b.*

implications for fulfilling its own responsibilities under AS 2101.06b and PCAOB Rules 3520 and 3526.

Two commenters on the 2021 SRC expressed concerns with the words "investigate" and "investigation" in the proposed amendments. The Board notes that the terms are used in other PCAOB auditing standards and generally refer to taking a closer look at a matter to determine a further course of action.¹⁴⁵ After considering the comments, the Board adopted this requirement as proposed.

Obtaining Information at the Individual or Firm Level

See note to paragraph .06D of AS 2101

The amendments include a note to AS 2101.06D stating that information required to be provided to the lead auditor under AS 2101.06D may cover the other auditor's firm and engagement team members who are partners, principals, shareholders, or employees of the other auditor firm.

Some commenters on the proposing releases questioned the practicability of applying the requirements to individual engagement team members. Further, one commenter on the 2021 SRC specifically asked for clarification regarding the level (i.e., firm, individual, or both) at which the lead auditor is expected to apply the requirements in paragraph .06Da (obtaining an understanding of other auditors' knowledge and experience) *and* how to interpret the proposed note to paragraph .06D.

The definition of "other auditor" in the amended standards includes both an other auditor firm and individuals at that firm. The affirmations and descriptions required by the amendments

¹⁴⁵ *See, e.g.,* paragraphs .17, .20–.21 of AS 2305, *Substantive Analytical Procedures* (investigation and evaluation of significant differences from expectations about assertions related to the financial statements).

could be prepared and provided by the other auditor firm and address all covered relationships. In our experience, firms typically have the necessary information available centrally, including information about processes for determining compliance with independence and ethics requirements, and about individuals at the firm, including their level of experience in applying the requirements. Obtaining from a firm a written affirmation or description that also encompasses relevant individuals at the firm would satisfy the requirement to obtain a written affirmation or description "from the other auditor" for those persons at that firm.

PCAOB Registration Status of Other Auditors

See paragraph .06G of AS 2101

PCAOB Rule 2100, *Registration Requirements for Public Accounting Firms*, requires a public accounting firm to be registered with the PCAOB¹⁴⁶ if it: (a) prepares or issues any audit report with respect to any issuer, broker, or dealer or (b) plays a substantial role in the preparation or furnishing of an audit report with respect to any issuer, broker, or dealer.¹⁴⁷ However, there have been examples of firms that played a substantial role but were not registered with the PCAOB.¹⁴⁸

¹⁴⁶ *See also* Section 102(a) of Sarbanes-Oxley, 15 U.S.C. 7212(a).

¹⁴⁷ An other auditor that is not registered with the PCAOB (regardless of whether such auditor is required to be registered with the PCAOB) is nonetheless subject to PCAOB authority when it acts as a person associated with a registered public accounting firm. *See* Section 2(a)(9) of Sarbanes-Oxley, 15 U.S.C. 7201(a)(9)); PCAOB Rule 1001(p)(i) (defining "person associated with a public accounting firm"); *see also* Sections 104(c)(1), 105(b)(1), and 105(c)(4) of Sarbanes-Oxley, 15 U.S.C. 7214(c)(1), 15 U.S.C. 7215(b)(1), and 15 U.S.C. 7215(c)(4) (articulating that PCAOB authority extends to "persons associated with a registered public accounting firm" in connection with inspections, investigations, and sanctions, respectively).

¹⁴⁸ *See, e.g., In the Matter of WWC, P.C.*, PCAOB Release No. 105-2022-006 (Apr. 19, 2022); *BDO Canada LLP (f/k/a BDO Dunwoody LLP)*, SEC AAER No. 3926 (Mar. 13, 2018); *KPMG Inc.*, SEC AAER No. 3927 (Mar. 13, 2018).

The amendments provide that the lead auditor may use the work of an other auditor that plays a substantial role on the audit¹⁴⁹ only if the other auditor is registered with the PCAOB.¹⁵⁰ The provision is intended to promote compliance with Rule 2100 and thereby enhance audit quality, and it does not change the rule or the related definition of "play a substantial role" in Rule 1001(p)(ii). Several commenters supported the provision, and the Board adopted it as proposed.

With regard to registration requirements more broadly, one commenter suggested – as an alternative to requirements concerning independence and ethics, and concerning knowledge, skill, and ability – that the Board require all audit firms "engaged in a public entit[y] assurance engagement" to be registered with the PCAOB. In the commenter's view, this approach would provide a "basis for consistent application [of PCAOB standards] for firms registered with the PCAOB." The Board is not taking the commenter's suggestion because simply requiring firms to register (beyond the current registration requirements) would not address the need for change identified in this rulemaking. The shortcoming of this approach is demonstrated by the inspection deficiencies and enforcement cases described above, which involve conduct by registered firms during audits involving other auditors.

Knowledge, Skill, and Ability of and Communications with Other Auditors

See paragraphs .06H and .16 of AS 2101

Knowledge, Skill, and Ability of Other Auditors

See paragraphs .06Ha-b and .16 of AS 2101

¹⁴⁹ See PCAOB Rule 1001(p)(ii).

¹⁵⁰ For audits in which the lead auditor divides responsibility for the audit with the referred-to auditor see AS 1206.06c in this document. See also discussion below.

The amendments require that, with respect to each other auditor, the lead auditor 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, including their: experience in the industry in which the company operates; knowledge of the relevant financial reporting framework, PCAOB standards and rules, and SEC rules and regulations; and experience in applying the standards, rules, and regulations. The amendments also require the lead auditor to obtain a written affirmation from the other auditor that its engagement team members possess the knowledge, skill, and ability to perform their assigned tasks.¹⁵¹

PCAOB standards have long recognized the importance of technical training and proficiency of the personnel performing the audit.¹⁵² 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 existing PCAOB standards, in situations where the lead auditor supervises an other auditor under AS 1201, the knowledge, skill, and ability of engagement team members with significant engagement responsibilities should be commensurate with the assessed risks of material misstatement.¹⁵³ In situations where the lead auditor uses the other auditor's work and

¹⁵¹ The written affirmation required by AS 2101.06Hb regarding the other auditor's engagement team members does not need to identify each member of the engagement team.

¹⁵² See, e.g., AS 1010, *Training and Proficiency of the Independent Auditor*; and paragraphs .11–.12 of QC 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*.

¹⁵³ See AS 2301.05a.

report under AS 1205, the lead auditor¹⁵⁴ is required under existing standards to make inquiries concerning the professional reputation of the other auditor.¹⁵⁵

The amendments build on and strengthen the existing provisions. Compliance with these amendments is not limited to preliminary engagement activities and should be reevaluated with changes in circumstances. The amendments seek to apply a balanced and practical approach by focusing the lead auditor's attention primarily on the knowledge, skill, and ability of the more senior engagement team members of the other auditor.

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, the knowledge, skill, and ability of the supervisory personnel include their experience in the company's industry and jurisdiction,¹⁵⁶ and knowledge of the relevant financial reporting framework, PCAOB standards and rules, and SEC rules and regulations. Lack of appropriate knowledge, skill, and ability by the other auditor's supervisory personnel can have an adverse effect on the overall quality of the audit.

Several commenters supported the proposed requirements, including the requirement to obtain a written affirmation from the other auditor that its engagement team members possess the knowledge, skill, and ability to perform their assigned tasks. One commenter asked the Board to consider providing that the lead auditor's procedures for obtaining an understanding of the

¹⁵⁴ "Principal auditor" is the term used in rescinded AS 1205.

¹⁵⁵ *See* AS 1205.10.

¹⁵⁶ As discussed below, AS 2101.16 states that the auditor should determine whether specialized skill or knowledge is needed to perform appropriate risk assessments, plan or perform audit procedures, or evaluate audit results, and the amendments specify that such specialized skill or knowledge may include "relevant knowledge of foreign jurisdictions."

knowledge, skill, and ability of the other auditor be scalable based on the considerations regarding sufficiency of participation in AS 2101.06A. The Board noted that the requirements in AS 2101.06A serve a different purpose: to increase the likelihood that the firm issuing the auditor's report meaningfully participates in the audit. The requirements regarding the knowledge, skill, and ability are designed to focus the lead auditor and other auditors on assigning qualified personnel at all levels of the audit engagement.

Another commenter suggested inserting a note after paragraph .06H that indicates the lead auditor's own experience working with the other auditor is relevant to the lead auditor's understanding of the other auditor's knowledge, skill, and ability. The Board agrees with the commenter that the lead auditor's own experience with the other auditor may be a source of information about the other auditor's knowledge, skill, and ability. However, the amendments are designed to be principles-based to accommodate a variety of scenarios in practice, whereby differing types of information about other auditors can be available to the lead auditor. Therefore, beyond requiring the written affirmation described above, the amendments do not prescribe a particular set of procedures or sources of information for obtaining an understanding of the other auditor's knowledge, skill, and ability. The amendments allow the lead auditor to determine the nature and extent of its procedures in this area. After considering the comments, the Board adopted the requirements as proposed.

The amendments also add an explanatory phrase, "including relevant knowledge of foreign jurisdictions," to AS 2101.16's existing requirement that the auditor should determine whether specialized skill or knowledge is needed to perform appropriate risk assessments, plan

or perform audit procedures, or evaluate audit results.¹⁵⁷ Identifying whether there is a need for specialized skill or knowledge is logically a prerequisite to evaluating whether someone has that skill or knowledge. For example, a lead auditor in its home jurisdiction may not have a sufficient understanding of the business practices or legal requirements of a foreign jurisdiction to be able to execute the audit effectively. In these cases, the lead auditor may want to consider whether to engage an other auditor (e.g., from that jurisdiction) with relevant knowledge of the foreign jurisdiction to appropriately assess risk, plan or perform audit procedures, or evaluate audit results.

One commenter on the 2021 SRC stated that, if added focus on knowledge of foreign jurisdictions is needed, additional clarity should be provided as to when this knowledge is needed and how it should be obtained. Another commenter stated that consideration of relevant knowledge of foreign jurisdictions may be applicable only in certain circumstances but acknowledged the possible need for specialized knowledge of foreign jurisdictions because of the other auditor's knowledge of the regulatory environment.

Similar to AS 2101.06Ha-b, the amendment in AS 2101.16 allows the auditor to determine the nature and extent of its procedures when determining whether specialized skill or knowledge is needed on the audit. After considering the comments, the Board adopted the amendment as proposed.

Communication with Other Auditors

See paragraph .06Hc of AS 2101

¹⁵⁷ See amended paragraph .16 of AS 2101, which provides that "[t]he 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."

The amendments to AS 2101 require the lead auditor to determine, in connection with using the other auditor's work, that it is able to communicate with the other auditor and gain access to the other auditor's audit documentation. The requirement is intended to help the lead auditor in identifying and addressing any communication or access issues early in the audit. For example, the lead auditor would consider whether it can have meaningful two-way communication with the other auditor¹⁵⁸ and whether it needs to address any language differences. In another example, the lead auditor would consider whether it can access the other auditor's documentation remotely.

The amendment also is based on the existing provisions of PCAOB standards that require the lead auditor to have access to the other auditor's documentation and obtain, review, and retain certain portions of it. As with the existing requirements, the amendments allow the lead auditor flexibility in determining the means of access (e.g., remotely or on-site).¹⁵⁹

If the lead auditor cannot obtain sufficient appropriate audit evidence because of restrictions on communicating with the other auditor or accessing its documentation, a limitation on the scope of the audit may exist. Under PCAOB standards, these circumstances may require the lead auditor to qualify the audit opinion or disclaim an opinion.¹⁶⁰

Those who commented on the proposed requirement in the 2016 Proposal and 2017 SRC viewed it as a clear requirement. Some commenters asked for examples of acceptable modes of

¹⁵⁸ See, e.g., AS 2110.49–.53 (describing discussions among key engagement team members regarding risks of material misstatement).

¹⁵⁹ See, e.g., rescinded AS 1205.12. See also AS 1215.18–.19.

¹⁶⁰ See AS 2810.35. See also paragraphs .05–.17 of AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances*, which contains requirements regarding audit scope limitations.

communication between the lead auditor and the other auditor, and inquired whether email communication would be acceptable. The Board notes that the form of communication between auditors (e.g., oral or written) depends on the circumstances of the audit and professional requirements (e.g., PCAOB standards require that certain communications between the lead auditor and other auditor be in writing¹⁶¹). Although PCAOB standards do not prescribe a particular type of written communication (e.g., print or electronic), they require that audit documentation, in whatever form, contain sufficient information to enable an experienced auditor, having no previous connection with the engagement, to understand the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached.¹⁶² In addition, the other auditor's audit documentation must be accessible by the lead auditor.¹⁶³ Further, audit documentation should demonstrate that the engagement complied with the standards of the PCAOB.¹⁶⁴

Consistent with the above discussion, the Board adopted the amendment as proposed.

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

See paragraph .14 of AS 2101

Other auditors are often involved in audits of companies with operations in multiple locations or business units ("multi-location engagements"). In these circumstances, existing AS 2101.11–.13 address the determination of the locations at which audit procedures should be

¹⁶¹ See, e.g., AS 1215.19.

¹⁶² See AS 1215.06a.

¹⁶³ See AS 1215.18, as amended.

¹⁶⁴ See AS 1215.05a.

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 should perform the procedures in paragraphs .11–.13 to determine the locations or business units where audit procedures should be performed.

In light of the rescission of AS 1205, the Board amended AS 2101.14 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. The amendment to AS 2101.14, together with the amended supervisory requirements in AS 1201, is intended by the Board to require that the lead auditor play the central role in determining the scope of the audit.

One commenter on the 2021 SRC recommended that the Board remove the requirements in proposed AS 2101.14 with regard to referred-to auditors because these requirements are not consistent with the principles underlying dividing responsibility (i.e., the approach would diminish the line between assuming and dividing responsibility). The Board noted that the amendment to this paragraph is consistent with the relevant requirements in existing AS 2101.14 applicable to audits that involve divided responsibility. For audits involving referred-to auditors, new AS 1206 describes interactions, including communication of the lead auditor's plan to divide responsibility, and other measures to assure the coordination of activities between the lead auditor and the referred-to auditor when dividing responsibility.¹⁶⁵

After considering the comments, the Board adopted the amendment as proposed.

Supervising Other Auditors

Overview of the Supervisory Approach

¹⁶⁵ See discussion below.

The Board's amendments are intended to improve the quality of audits that involve other auditors for whose work the lead auditor assumes responsibility by requiring, among other things, that the lead auditor supervise the other auditors under AS 1201, as amended.

Currently, the risk-based supervision approach described in AS 1201 does not apply to situations in which the lead auditor uses the work and reports of other auditors under AS 1205. AS 1205, which the Board rescinded, requires the lead auditor¹⁶⁶ to perform certain procedures, when using the work and reports of other auditors, that are more limited in scope than those required by the supervision standard, AS 1201. The 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.¹⁶⁷ The amendments also supplement the general supervisory requirements in AS 1201.05 by providing direction for applying these requirements in an audit involving other auditors.¹⁶⁸

AS 1201 currently sets forth the general framework for supervision of engagement team members, including the nature and extent of supervisory activities. The standard allows the engagement partner to seek assistance in fulfilling his or her supervisory responsibilities from appropriate engagement team members, which includes team members from other firms involved in the audit.¹⁶⁹ While AS 1201 describes supervisory *activities*, it does not, however, describe

¹⁶⁶ "Principal auditor" is the term used in AS 1205.

¹⁶⁷ For situations in which the lead auditor divides responsibility for the audit with another accounting firm, see AS 1206. For certain audits involving investments accounted for under the equity method of accounting whose financial statements are audited by other auditors, see proposed rule text for changes to Appendix B of AS 1105.

¹⁶⁸ See AS 1201.07–.15.

¹⁶⁹ See AS 1201.04.

supervisory *procedures* or assign them to a particular member, or members, of the engagement team. Further, the standard does not differentiate between the supervisory responsibilities of engagement team members at the lead auditor and at the other auditor.

Under PCAOB standards, the audit firm that issues the audit report is responsible for making sure that sufficient appropriate audit evidence has been obtained, and appropriately evaluated, to support the opinion in the audit report.¹⁷⁰ Because of the lead auditor's central role in the audit, the amendments the Board adopted require that certain supervisory *procedures* be performed by the lead auditor. These procedures are designed to improve the effectiveness of the lead auditor's supervision of the work of other auditors.

The amendments also are designed to be scalable by applying the existing principles in AS 1201, which are already familiar to auditors. When designing and performing supervisory activities the lead auditor determines 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.¹⁷¹ For example, the extent of the lead auditor's supervision of the other auditors' work depends on, among other things, the risks of material misstatement to the company's financial statements and the knowledge, skill, and ability of the other auditors.¹⁷²

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

¹⁷⁰ See AS 2810 regarding evaluating the sufficiency and appropriateness of audit evidence.

¹⁷¹ See AS 1201.07.

¹⁷² See AS 1201.06.

in the amendments. For procedures not assigned to the lead auditor under the amendments, the lead auditor may seek assistance from qualified engagement team members (including those at the other auditor) in supervising the work.¹⁷³ The approach to supervising other auditors under the amendments is consistent with, and takes into account, recent developments at some accounting firms that have been observed through the Board's oversight activities.¹⁷⁴

Many commenters on the 2021 SRC noted that communications between the lead auditor and other auditors are iterative throughout the audit. In addition, some commenters stated that it was not clear to them whether under the amendments in the 2021 SRC other auditors can provide input to the lead auditor on certain issues.

The Board agrees with commenters that effective supervision by the lead auditor typically necessitates two-way communication with the other auditor. Similar to the amendments proposed in the 2021 SRC, the final amendments are designed to foster effective interaction by requiring the lead auditor to, as necessary, hold discussions with and obtain information from the other auditors to facilitate the performance of the supervisory procedures.¹⁷⁵

The amendments to AS 1201 do not include the statement contained in rescinded AS 1205.03 that "the other auditor remains responsible for the performance of his own work and

¹⁷³ See AS 1201.04.

¹⁷⁴ See further discussion above.

¹⁷⁵ See, e.g., note to AS 1201.08 and AS 1201.10 (requiring the lead auditor to discuss with the other auditor any changes to its planned audit procedures), both of which were originally introduced in the 2016 Proposal. In addition, the amendments include a reference to paragraphs .49–.53 of AS 2110, *Identifying and Assessing Risks of Material Misstatement* (in a footnote to AS 1201.08) to remind the lead auditor of certain other required interactions with the other auditor. See discussion below.

for his own report." Nevertheless, the Board believes that supervision by the lead auditor does not relieve other auditors of their responsibilities, which include applying due professional care and complying with PCAOB standards. To reinforce this principle, the amendments add a statement to AS 1015, that other auditors are responsible for performing their work with due professional care.¹⁷⁶ This statement reminds other auditors of their responsibility to perform work in compliance with PCAOB rules and standards.¹⁷⁷ Commenters were supportive of this added statement, noting that it was clear and appropriate. That responsibility is further emphasized by (i) an amendment requiring an affirmation from the other auditor about its compliance with the lead auditor's instructions¹⁷⁸ and (ii) an amendment regarding audit documentation requirements.¹⁷⁹ The overall responsibility for the audit under the amendments remains, however, with the lead auditor, as is the case under the existing standards.¹⁸⁰

Supervisory Procedures to Be Performed by the Lead Auditor

Under the amendments to AS 1201, the engagement partner remains responsible for the engagement and its performance. Accordingly, the engagement partner is responsible for proper supervision of the work of engagement team members, including the work of engagement team

¹⁷⁶ See note to AS 1015.01 ("For audits that involve other auditors, the other auditors are responsible for performing their work with due professional care.").

¹⁷⁷ This amendment would not, of course, establish the sole responsibilities of other auditors. Like all auditors that participate in an audit performed under PCAOB standards, other auditors must comply with all applicable PCAOB standards. See, e.g., PCAOB Rule 3100, *Compliance with Auditing and Related Professional Practice Standards*.

¹⁷⁸ See AS 1201.11, which is discussed below.

¹⁷⁹ See AS 1215.18, which is discussed below.

¹⁸⁰ To emphasize this point, the amendments add a footnote to AS 1015.01, referring to AS 2101 and AS 1201, which set forth the lead auditor's responsibilities for planning and supervising the other auditor's work.

members outside the engagement partner's firm. In fulfilling his or her supervisory responsibilities, the engagement partner may seek assistance from appropriate engagement team members, including engagement team members outside the engagement partner's firm.

Engagement team members who assist the engagement partner with supervision should exercise their supervisory responsibilities in accordance with AS 1201.

With respect to the lead auditor's supervisory procedures in the amendments, 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 planning and supervision, are eligible to perform such procedures. In addition, in multi-tiered audits, the lead auditor may seek assistance from a first other auditor in performing the supervisory procedures in the amendments.¹⁸¹

To provide more specific direction for supervising the other auditors' work, the amendments to AS 1201 establish requirements for the lead auditor in the following areas:

- Informing other auditors of their responsibilities;
- Obtaining and reviewing a description of the audit procedures to be performed by other auditors;
- Obtaining and reviewing a written affirmation that other auditors performed their work in accordance with the lead auditor's instructions;
- Directing other auditors to provide specific documentation regarding their work; and

¹⁸¹ See AS 1201.14.

- Determining whether other auditors have performed the work assigned to them, and whether additional evidence should be obtained.

As noted in AS 1201.07, these requirements supplement the requirements in AS 1201.05. The requirements imposed by the amendments are described in new paragraphs AS 1201.08-.13 and discussed in more detail below.¹⁸²

Informing Other Auditors of Their Responsibilities

See paragraph .08 of AS 1201

AS 1201 currently requires that engagement team members be informed of their responsibilities, including the objectives and the nature, timing, and extent of the procedures to be performed, and other relevant matters.¹⁸³ 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.¹⁸⁴

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

¹⁸² The amendments also specify certain supervisory responsibilities in multi-tiered audits, as discussed below.

¹⁸³ *See* AS 1201.05a.

¹⁸⁴ 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 as to the scope of audit work.

- The scope of work to be performed by the other auditor (e.g., location or business unit¹⁸⁵ 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,¹⁸⁶ tolerable misstatement,¹⁸⁷ and the amount (if determined) below which misstatements are clearly trivial and do not need to be accumulated.¹⁸⁸

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 (some of whom also commented on the 2021 SRC) recommended that the lead auditor be required to

¹⁸⁵ As discussed above, in multi-location engagements that involve other auditors, the lead auditor is required to determine locations or business units at which audit procedures should be performed.

¹⁸⁶ See AS 2110.49–.53 (referenced in a footnote to 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. The Board has adopted an additional reference reminding auditors of the requirements in AS 2110.59 regarding the auditor's responsibility to identify and assess the risks of material misstatement at the (consolidated) financial statement level and the assertion level.

¹⁸⁷ See AS 2105.08–.10 (referenced in a footnote to 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 above, it is common for audits using other auditors to take place in different locations, including different countries.

¹⁸⁸ See AS 2810.10–.11 (referenced in a footnote to 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 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.

communicate only the significant risks or only risks that are relevant to the other auditors' work. Some commenters agreed that the communication by the lead auditor to the other auditor about the scope of work, identified risks of material misstatement, and the amount (if determined) below which misstatements are clearly trivial and do not need to be accumulated, should be in writing.

In the 2021 SRC, the Board agreed 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. The Board therefore included in AS 1201.08b in the 2021 SRC the qualifying phrases "[w]ith respect to the work requested to be performed" and "to the consolidated financial statements that are associated with the location or business unit."¹⁸⁹ These phrases remain in the final amendments. The 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 on the proposing releases 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. Further, a couple of commenters to the 2021 SRC recommended that the amendments not require the lead auditor to communicate identified risks of material misstatements that are applicable to the location or business unit. Instead, the commenters recommended a requirement that focuses the lead auditor on communicating identified risks to

¹⁸⁹ To align with similar language in AS 2101.11, the amendments have been revised from the 2021 SRC in AS 1201.08b(1) to change "the identified risks ... that are applicable to the location or business unit" to "associated with the location or business unit."

the consolidated financial statements and matters that would assist the other auditor in developing a more granular view of risks specific to the location or business unit.

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.¹⁹⁰

The Board agrees with commenters that input from other auditors may be necessary in identifying and assessing risks of material misstatement to the company's financial statements and developing an audit response. The amendments are designed to foster effective two-way communication by requiring the lead auditor to, as necessary, hold discussions with and obtain information from other auditors to facilitate the performance of the supervisory procedures.¹⁹¹ Notably, all key engagement team members, including those at the other auditor firms, are already required under existing standards 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.¹⁹² A reminder about these requirements is included in a footnote to AS 1201.08.¹⁹³

¹⁹⁰ See AS 2110.49-53.

¹⁹¹ A note to AS 1201.08 provides 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 paragraph .08.

¹⁹² See AS 2110.49-.53.

¹⁹³ See footnote 15 to AS 1201.08, citing AS 2110.49-.53, which require key engagement team members (including those in differing locations) to hold discussions regarding

The Board also agrees with commenters that under the existing requirements the lead auditor identifies and assesses the risk of material misstatement at the level of the company's (consolidated) financial statements. An additional reference was added to the amendments reminding lead auditors of the existing requirements of AS 2110.59 to identify and assess the risks of material misstatement at the financial statement level and assertion level.¹⁹⁴

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

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.¹⁹⁵ 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.¹⁹⁶ In situations governed by AS 1205, the lead auditor is required to consider reviewing the audit programs of the other auditor.¹⁹⁷

Similar to the proposed amendments in the 2021 SRC, the final amendments to AS 1201 require the lead auditor to obtain and review the other auditor's written description of audit

risks of material misstatement due to error or fraud, which inform the identification and assessment of risks.

¹⁹⁴ See footnote 15 to AS 1201.08.

¹⁹⁵ See AS 2101.10.

¹⁹⁶ See AS 1201.05a(2).

¹⁹⁷ See rescinded AS 1205.12.

procedures to be performed,¹⁹⁸ 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.¹⁹⁹ Under these amendments, the lead auditor is 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.

The amendments are intended to promote proper supervision of the other auditor's work by the lead auditor and proper coordination of work performed by the lead and other auditor. Importantly, the 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 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.²⁰⁰

Many commenters on the 2021 SRC recommended that these requirements for the lead auditor be more principles-based to better accommodate an iterative process of communication between the lead auditor and other auditors, and the use of communication technology. For example, some commenters indicated that planned audit procedures and related changes could be

¹⁹⁸ See AS 1201.09.

¹⁹⁹ See AS 1201.10.

²⁰⁰ See note to AS 1201.09.

communicated through video conferencing and screen sharing instead of in writing. These commenters encouraged the Board to revise AS 1201.09 and .10 to make them more principles-based and to reflect the recent technological innovations in communication. A couple of commenters went further and recommended removing from the amendments the requirement to "obtain" the information. A couple of other commenters either recommended that the Board allow the lead auditor to apply judgment in determining what changes should be communicated in writing to the other auditor based on the lead auditor's extent of supervision of the other auditor, or stated that the requirement could cause an other auditor that is not a member of the lead auditor's network to be concerned about the confidentiality of its audit methodology.

In its oversight activities, the PCAOB has seen challenges in the coordination and communication between lead auditors and other auditors, particularly in coordinating their responsibilities for the planning and performance of audit procedures. Requiring that certain communications be in writing facilitates the supervision of the engagement by reducing the risk of miscommunication and lack of clarity about responsibilities.

The terms "obtain" and "in writing" do not mandate that auditor working papers be paper-based.²⁰¹ The Board believes that technological advances in communication including those discussed by commenters could improve the effectiveness and efficiency of the lead auditor's supervision of other auditors, and the Board noted that the amendments would not hamper the implementation of novel means of communication, including documentation and review.

For example, a lead auditor could meet with other auditors through video conferencing and could view and discuss documents that are shared by video screen. The lead auditor could

²⁰¹ See AS 1215.04 (audit documentation may be in the form of paper, electronic files, or other media).

also obtain documents by (i) receiving them via electronic mail or by downloading them via an electronic portal and could store them electronically or (ii) accessing the other auditor's electronic working papers remotely. In any case, audit documentation supporting the lead auditor's conclusions will need to contain a record that the lead auditor fulfilled its responsibilities under PCAOB standards, including reviewing the relevant documents and meeting the requirements of other provisions and of other standards regarding matters such as determinations related to other auditors' work²⁰² and audit documentation.²⁰³

As with paper-based documentation of the work of other auditors, the necessary level of detail of the other auditors' electronic documentation that is required to be requested, obtained, and reviewed by the lead auditor and the lead auditor's communication to the other auditors under the amendments will depend on the necessary extent of supervision of the other auditors' work by the lead auditor.

Separately, requiring the lead auditor to obtain a written description of audit procedures to be performed from the other auditor and communicate changes in writing to the other auditor not only allows the Board to fulfill its mandates of inspecting and potentially investigating the lead auditor's oversight of the other auditor's work but it is also important for an audit firm's audit quality reviews such as engagement quality reviews and internal inspections. For the reasons discussed above, the Board adopted these requirements as proposed.

²⁰² See, e.g., AS 1201.13 (requiring the lead auditor to make certain determinations based on a review of the documentation provided by the other auditor, discussions with the other auditor, and other information obtained by the lead auditor).

²⁰³ See, e.g., AS 1215.06 and AS 1215.18 as amended.

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

See paragraph .11 of AS 1201

As was proposed in the 2021 SRC, under the amendments the lead auditor is required to obtain and review a written affirmation as to whether the other auditor performed work in accordance with the instructions provided, as described in paragraphs AS 1201.08–.10, including the other auditor's use of applicable PCAOB standards in performing that work. If the other auditor has not performed the work in accordance with the instructions provided, the lead auditor is required to obtain and review 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.

This requirement is designed to provide information to the lead auditor about whether the other auditor performed work in accordance with the lead auditor's instructions, to inform the lead auditor of audit areas that may require additional attention, and to emphasize the other auditor's responsibility for properly planning and performing its work in compliance with PCAOB standards. It is also consistent with the existing practice of affirming in writing an other auditor's compliance with the lead auditor's instructions (e.g., in an "interoffice memorandum") at some audit firms. AS 1201.11 does not duplicate a requirement in AS 1215.19 for the lead auditor to obtain, review, and retain certain documents relating to the other auditor's work.

Commenters on the 2021 SRC supported the written affirmation in AS 1201.11 as they believed it was a necessary requirement, and the Board adopted it as proposed.

Directing the Other Auditors to Provide Specific Documentation

See paragraph .12 of AS 1201

Supervision under existing PCAOB standards necessarily involves review of audit documentation.²⁰⁴ 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 specify the documents to be reviewed.) In addition, for audits involving other auditors, other 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.²⁰⁵

As the Board proposed in the 2021 SRC, the amendments 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 of the other auditor. 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 and that supports the lead auditor's obligation to obtain sufficient appropriate audit evidence to provide a reasonable basis for its opinion.

The amendments also state that the documentation requested by the lead auditor from the other auditor depends 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 amendments, review of additional documentation (i.e., beyond the items listed in AS 1215.19) could be necessary to satisfy the lead auditor's supervisory responsibilities, for example, for work

²⁰⁴ *See, e.g., AS 1201.05c.*

²⁰⁵ *See, e.g., AS 1215.19 and rescinded AS 1205.12.*

performed by less experienced other auditors, procedures in areas with heightened risks of material misstatement (including the other auditors' testing of controls that address the risks), or procedures to resolve significant issues arising during the audit. In directing the other auditor, the lead auditor could, for example, specify individual documents, types of documents, or documentation for audit areas that it intends to review.

One commenter generally supported the changes to proposed AS 1201.12 in the 2021 SRC that acknowledge the lead auditor's use of a risk-based approach in determining the documentation to review in performing its supervisory responsibilities. Another commenter recommended that the amendments clarify that determining the necessary incremental documentation for the lead auditor to review (in addition to documents described in PCAOB standards) should be based on the facts and circumstances of an audit engagement. Another commenter on the 2021 SRC stated that privacy laws in certain jurisdictions may create obstacles for the transfer of documentation from the other auditor's country to the lead auditor's country. And another recommended clarifying that not all the documentation described in AS 1215.19 may be applicable in some situations. For example, in situations where the other auditor's involvement consists of only performing certain limited procedures (e.g., observing a company's physical inventory), certain documents in AS 1215.19 would not be applicable.

The Board considered these comments and determined that the requirements as proposed were sufficiently clear. The Board therefore adopted the requirements as proposed. As noted previously, the amendments specifically state that the documentation requested by the lead auditor from the other auditor will be based on the necessary extent of supervision of the other auditor's work by the lead auditor (which depends on a number of factors, including risks of material misstatement and the knowledge, skill, and ability of the other auditor).

Additionally, with regard to privacy laws and potential challenges to accessing working papers, if effective methods of remote access to the working papers are available to the lead auditor, the amendments do not preclude the use of such methods. However, as is the case under the existing requirements, engagement team members from the lead auditor may need to travel to the country where the working papers are located to access the working papers and perform their review. The amendments do not change the existing requirement in AS 1215.19 for obtaining, reviewing, and retaining certain documentation related to the other auditor's work by the office of the firm issuing the auditor's report. If the lead auditor cannot obtain sufficient appropriate audit evidence, a limitation on the scope of the audit may exist. This may require the engagement partner to qualify the audit opinion or disclaim an opinion.²⁰⁶

Finally, the Board agrees with the commenter that in situations in which the other auditor only performs select procedures for the lead auditor, such as observing physical inventories, the lead auditor is not required to obtain all of the documents described in AS 1215.19, because those documents would not be applicable to the limited type of work performed by the other auditor. However, this does not reduce the need for the lead auditor to obtain documentation prepared by the other auditor that is sufficient to fulfill its supervisory responsibilities under AS 1201.²⁰⁷

Determining Whether the Other Auditor Has Performed the Work, and Whether
Additional Evidence Should Be Obtained

See paragraph .13 of AS 1201

²⁰⁶ See AS 2810.35. *See also* paragraphs .05–.15 of AS 3105, Departures from Unqualified Opinions and Other Reporting Circumstances.

²⁰⁷ *See also* AS1215.A65.

Under the general supervisory requirements of AS 1201, the engagement partner and his or her assistants should review the work of engagement team members to evaluate whether: (i) the work was performed and documented; (ii) the objectives of the procedures were achieved; and (iii) the results of the work support the conclusions reached.²⁰⁸ In the scenarios that are governed by rescinded AS 1205, the lead auditor should consider performing one or more specified procedures in addition to obtaining, reviewing, and retaining certain documentation of the other auditor's work.

Under the amendments, AS 1201.13 provides that the lead auditor should determine, based on a review of the documentation provided by the other auditor, discussions with the other auditor, and other information obtained by the lead auditor during the audit: (i) whether the other auditor performed the work in accordance with the lead auditor's instructions, including the use of applicable PCAOB standards; and (ii) whether additional audit evidence should be obtained by the lead auditor or other auditors. Notably, the amendments do not require that in all cases the lead auditor review all the documentation of the other auditor's work to determine whether the work has been performed. Rather, the lead auditor's determination should be based on the review of documents it requested from the other auditor under the amendments, discussions with the other auditors, and other information obtained during the audit.

The requirement to determine the need for additional evidence is intended to address circumstances that may be encountered in practice, including where the other auditors did not

²⁰⁸ See AS 1201.05c. Additionally, AS 1201.05b requires the engagement partner or other supervisors to direct engagement team members to bring significant accounting and auditing issues to their attention so they can evaluate those issues and determine that appropriate actions are taken in accordance with PCAOB standards. That requirement also applies in the supervision of other auditors.

perform the procedures as instructed, or where sufficient appropriate audit evidence was not obtained. In those situations, the lead auditor would need to determine the appropriate next steps. For example, the lead auditor could determine that it is necessary for the lead auditor or the other auditor to perform additional audit procedures to address a previously unidentified risk of material misstatement or to obtain further audit evidence with respect to one or more locations or business units.²⁰⁹

Commenters did not oppose or suggest modifications to the proposed requirements in AS 1201.13, and the Board adopted them as proposed.

Multi-Tiered Audits

See paragraphs .14–.15 of AS 1201 and paragraphs .06Ac, .06E, and .06I of AS 2101

Supervisory Procedures in Multi-tiered Audits – Directing a First Other Auditor

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.

In addition to describing multi-tiered audits, the amendments 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 (i.e., procedures in paragraphs .08–.13 of AS 1201). Multi-tiered audits are described in the standard as 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.²¹⁰

²⁰⁹ See AS 1201.13. See also AS 2810.35 and .36 (which are referenced in a footnote to AS 1201.13b), requiring the auditor, among other things, to obtain further audit evidence if sufficient appropriate audit evidence has not been obtained.

²¹⁰ See footnote 19 to AS 1201.14.

Under the amendments, the lead auditor determines whether to seek assistance from a first other auditor in supervising one or more second other auditors, pursuant to factors in AS 1201.06.²¹¹ Notably, however, the lead auditor is responsible for the supervision of the entire audit, including the supervision of all other auditors.

For example, a multi-tiered audit of a U.S. 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 amendments, the lead auditor could seek assistance from the U.K. firm in supervising the work of the second other auditor in Germany. 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.

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 should be based on the factors for determining the extent of supervision in AS 1201.06.

The lead auditor's use of a first other auditor is entirely within the lead auditor's discretion. The lead auditor could decide not to seek assistance from the first other auditor in supervising the work of second other auditors where, for example, the first other auditor's

²¹¹ AS 1201.14.

knowledge of a particular industry, particular accounting or auditing area, or PCAOB rules and standards is insufficient to effectively review the work of the second other auditors.

A commenter on the 2021 SRC asserted that the description of multi-tiered audits as proposed in footnote 19 to AS 1201.14 does not provide sufficient context for circumstances that might give rise to multi-tiered audits. The commenter suggested an alternative description that would be based on the financial reporting structure of an entity, which the commenter viewed as more important to defining the concept of a multi-tiered audit than the audit structure.²¹² Having considered the comment, the Board decided to adopt the amendments as proposed in the 2021 SRC. The description of multi-tiered audits in the amendments and the related requirements are discussed in the context of existing auditor responsibilities, to illustrate how the existing responsibilities apply when an audit includes one or more supervisory tiers.

Another commenter recommended that the description of multi-tiered audits be moved to the definitions section in Appendix A of AS 2101. The Board has decided not to relocate the description of "multi-tiered audits" to Appendix A of AS 2101, as it is not intended to be a defined term in the standards, but rather a description of a current practice.

Supervisory Procedures in Multi-tiered Audits – Evaluating a First Other Auditor's

Supervision of a Second Other Auditor's Work

Under the amendments, the lead auditor is responsible for the supervision of the entire audit, including the supervision of all the other auditors' work. If a first other auditor performs supervisory procedures with respect to a second other auditor, the lead auditor is required to

²¹² The commenter provided the rationale that a multi-tiered audit may exist even if the first other auditor does not assist the lead auditor in supervising the work of a second other auditor.

evaluate the first other auditor's supervision of the second other auditor's work.²¹³ If the first other auditor assists the lead auditor with performing the supervisory procedures described in AS 1201.14, the lead auditor is required to obtain, review, and retain documentation identifying the scope of work to be performed by the second other auditor.²¹⁴ The requirements for the supervision of the other auditor's work in a multi-tiered audit also apply to audits in which there are multiple second other auditors.²¹⁵

Under the amendments, the lead auditor will consider the first other auditor's review of the second other auditor's work, and 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.²¹⁶ 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 and maintains documentation sufficient to understand the supervisory procedures performed with respect to the second other auditor, and if no unexpected issues arise during the audit.

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 (including the second other auditor's supervision of the work of

²¹³ See AS 1201.14.

²¹⁴ See AS 1201.14.

²¹⁵ See also discussion below.

²¹⁶ See AS 1201.15.

further tiers of other auditors²¹⁷) 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 1215.19.²¹⁸ In other words, the amendments would not require the first other auditor to provide to the lead auditor multiple sets of the same type of documentation; for example, 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 auditor(s).

One commenter on the 2021 SRC supported the requirements and stated that they provided the right approach to multi-tiered audits. Another commenter indicated that the lead auditor should be able to place greater reliance on a first other auditor than the proposed requirements allowed, including relying on the first other auditor to determine the extent of supervision of second other auditors. In addition, this commenter stated that it disagreed with the requirement that the lead auditor should obtain and review documentation that identifies the scope of work for each location or business unit in a multi-tiered audit, although it agreed that the lead auditor needed such information in order to consider whether (and if so, the extent to which) it should be involved in the work of the second other auditor.

With regard to the comment that the lead auditor should be able to place greater reliance on a first other auditor, including relying on the first other auditor to determine the extent of supervision of second other auditors, the aim of this rulemaking is to increase the lead auditor's involvement in and evaluation of the other auditors' work. This includes the lead auditor's supervision of the work of second other auditors in multi-tiered audit scenarios. Allowing the lead auditor to simply rely on the first other auditor's supervision of a second other auditor, as

²¹⁷ See discussion below.

²¹⁸ See note to AS 1201.14.

recommended by the commenter, would not be consistent with this goal. As stated above, under the amendments, the lead auditor determines its extent of supervision of the second other auditor's work in accordance with the factors in paragraph AS 1201.06.

With regard to the comment that the lead auditor should not have to obtain and review documentation that identifies the scope of work for each location or business unit in a multi-tiered audit, the Board continues to believe that obtaining and reviewing such documentation is critical for informing the lead auditor's supervision of the other auditors' work. Supervision of the engagement, including the work of second other auditors, is the lead auditor's responsibility, and the lead auditor's knowledge of the scope of the work of second other auditors is necessary to effectively discharge that responsibility.

One commenter on the 2021 SRC expressed concerns about how the requirement to evaluate a first other auditor's supervision of a second other auditor would be operationalized, in particular what information would be taken into account in making the evaluation. This commenter recommended that requiring an up-front discussion between the lead auditor and the first other auditor about how second other auditors will be used and supervised would be more beneficial to audit quality. This commenter also stated that because it may not always be possible to observe the nature and extent of the review performed by the first other auditor, the standard should require the lead auditor to obtain a written affirmation from the first other auditor that the second other auditor has been supervised as agreed with the lead auditor (similar to the requirement in AS 1201.11).

When evaluating the first other auditor's supervision of the second other auditor's work, the lead auditor would not, in normal circumstances, be expected to reperform the first other auditor's supervisory procedures. Instead, the lead auditor would evaluate whether the first other

auditor properly performed the assigned supervisory procedures with respect to the second other auditor, coordinated its work with the second other auditor, and resolved significant matters arising during the audit. The lead auditor's evaluation may include holding discussions with the first other auditor and reviewing the first and second other auditors' audit plans, written reports, or other documentation. Overall, the extent of the lead auditor's evaluation of the first other auditor's supervision depends on the nature of the work performed by the second other auditor, the results of the work, and the necessary extent of the lead auditor's supervision of the first other auditor's work.

The Board does not agree with the recommendation that the lead auditor obtain a written affirmation from the first other auditor that the second other auditor has been supervised as agreed with the lead auditor. Under the amendments, the lead auditor is responsible for supervision of the entire engagement, including supervision of the first other auditor's supervision of second other auditors. An affirmation, by itself, may not provide information that is sufficient to discharge this responsibility. In some circumstances, for example, where the risks of material misstatements are higher, the lead auditor would need to evaluate more information than an affirmation to fulfill its responsibility to supervise the entire engagement, including the involvement of other auditors, to a necessary extent under PCAOB standards. Having considered the comments, the Board adopted the amendments as proposed in the 2021 SRC.

Audit Planning in Multi-tiered Audits – Serving as Lead Auditor and Seeking Assistance from a First Other Auditor Related to a Second Other Auditor's Qualifications

As discussed in more detail above, the 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.²¹⁹ 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, this consideration applies 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 a first other auditor in a multi-tiered audit.

Some commenters indicated that with respect to determining the sufficiency of participation of the lead auditor, the amendments regarding supervisory assistance from other auditors in a multi-tiered audit are clear and appropriate. There were no comments opposing these amendments, and the Board adopted them as proposed.

Under the final amendments, the lead auditor may seek assistance from a first other auditor in performing procedures relating to a second other auditor's qualifications, including (i) compliance with independence and ethics requirements (under AS 2101.06D),²²⁰ and (ii) knowledge, skill, and ability, and certain other items (under AS 2101.06H).²²¹

The amendments emphasize that the lead auditor remains responsible for determining the audit engagement's compliance with the independence and ethics requirements pursuant to AS 2101.06b.²²² If the lead auditor seeks assistance from the first other auditor, it should instruct the first other auditor to inform the lead auditor of the results of procedures, including bringing to

²¹⁹ See AS 2101.06Ac.

²²⁰ See AS 2101.06E.

²²¹ See AS 2101.06I. This provision does not change the existing requirement for the other auditors' documentation (including the second other auditor's) to be accessible to the office issuing the auditor's report. (See AS 1215.18 as amended.)

²²² See *id.*

the lead auditor's attention any information indicating that a second other auditor is not in compliance with the independence and ethics requirements.²²³ Further, allowing the lead auditor to seek assistance from a first other auditor regarding the second other auditor's knowledge, skill, and ability is consistent with the existing supervisory requirement in AS 1201.06, which provides that an auditor (first other auditor in this instance) should take into account the second other auditor's qualifications to determine the necessary extent of supervision of the second other auditor's work.²²⁴

A couple of commenters agreed that the requirements applicable to multi-tiered audits relative to the planning procedures regarding a second other auditor's qualifications were clear and appropriate and supported the notion that the first other auditor is often best suited to perform these procedures. However, one commenter had concerns with the placement of the requirement related to knowledge, skill, and ability in a multi-tiered audit and suggested relocating it from AS 2101.06I to a note to AS 2101.06H but did not provide reasons for the concern. The same commenter also recommended that the first other auditor be expected to communicate to the lead auditor any concerns about the second other auditor's knowledge, skill, and ability.

With regard to the commenter's point on relocating the requirement to a note, the Board considered the comment but determined that moving the requirement to a note in AS 2101.06H is not necessary as its placement in a paragraph is sufficiently clear. Regarding a first other auditor's concerns about the second other auditor's knowledge, skill, and ability, a key element for determining the extent of supervision necessary is taking into account an engagement team

²²³ See AS 2101.06E.

²²⁴ See AS 1201.06d.

member's knowledge, skill, and ability.²²⁵ If the first other auditor had concerns regarding the knowledge, skill, and ability of a second other auditor, the first other auditor would take this into account and increase the extent of its supervision of the second other auditor's work.

Additionally, under AS 1201.13, the first other auditor is required to determine – based on a review of the documentation provided by the second other auditor (pursuant to AS 1201.09–.12), discussions with the second other auditor, and other information obtained by the lead auditor during the audit – whether the second other auditor performed the work in accordance with the instructions and whether additional audit evidence should be obtained by the first other auditor, second other auditor, or the lead auditor. Having considered the comments received, the Board adopted the requirements as proposed.

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 above, the business unit in Germany could acquire a company in Belgium, audited by a local firm, and the second other auditor in Germany could supervise and use the work of its Belgian counterpart (a third other auditor). As noted, the lead auditor could seek assistance from the U.K. firm in supervising the work of the second other auditor in Germany, which would include the German firm's supervision of the third other auditor in Belgium.

PCAOB standards are designed to work in situations involving multiple tiers of other auditors. While the amendments are focused on the planning and supervision responsibilities of the lead auditor, other requirements of PCAOB standards apply, and would continue to apply under the amendments, to all auditors involved in the audit. For example, in determining the

²²⁵ *See id.*

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. No commenters expressed views different from the approach in the 2021 SRC regarding further tiers of other auditors. Therefore, the Board adopted the requirements as proposed.

Dividing Responsibility for the Audit with Another Accounting Firm

See AS 1206

AS 1206, a new standard, specifically addresses the lead auditor's division of responsibility for the audit with another accounting firm (i.e., a referred-to auditor).²²⁶ It carries forward, with certain modifications, relevant requirements for the divided-responsibility scenario that are in rescinded AS 1205.²²⁷ Currently, divided-responsibility engagements are relatively uncommon.²²⁸

AS 1206 applies when the lead auditor divides responsibility for an audit of the financial statements and, if applicable, ICFR. Similar to AS 1205, the new standard does not require the lead auditor to supervise the referred-to auditor's work. Rather, each auditor is required to supervise its respective engagement team members in accordance with AS 1201.²²⁹

²²⁶ Rescinded AS 1205 did not use the term "referred-to auditor." The definition of referred-to auditor is discussed above in this release.

²²⁷ As discussed above, AS 1205 also includes requirements for audits in which the auditor assumes responsibility for the work of another firm.

²²⁸ 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.

²²⁹ With respect to supervision, if there is more than one referred-to auditor, the requirements in AS 1206.03–.09 apply to the lead auditor regarding each referred-to auditor

These requirements apply in circumstances where the lead auditor decides to refer to the work of the referred-to auditor in its auditor's report. In such circumstances, the lead auditor does not assume responsibility for the work of the referred-to auditor. Instead, the lead auditor discloses the division of responsibility between the lead auditor and the referred-to auditor and the magnitude of the portion of the audit performed by the referred-to auditor.

Under AS 1206, both the lead auditor and referred-to auditor remain responsible for their respective audits. For example, both the lead auditor and referred-to auditor are required to comply with PCAOB standards when planning and performing their respective audits, including making materiality determinations, and issuing audit reports.²³⁰

AS 1206 sets forth certain requirements for the lead auditor, which carry forward or strengthen the requirements of AS 1205. For example, AS 1206 requires the lead auditor to:

- Determine that audit procedures are performed, in coordination with the referred-to auditor, with respect to the consolidation or combination of the portions of the financial statements audited by the referred-to auditor;²³¹
- Obtain a written representation from the referred-to auditor regarding the referred-to auditor's independence under requirements of the PCAOB and the SEC;²³²
- Determine, based on inquiries made to the referred-to auditor and other information obtained by the lead auditor during the audit, that the referred-to auditor is familiar

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.

²³⁰ See, e.g., AS 2101.11–.14 and AS 2105.10.

²³¹ See AS 1206.03 and AS 1205.10.

²³² See AS 1206.05a and AS 1205.10b.

- with the relevant requirements of the applicable financial reporting framework, the standards of the PCAOB, and the financial reporting requirements of the SEC;²³³ and
- Disclose in its auditor's report (i) the division of responsibility between the lead auditor and the referred-to auditor and (ii) the magnitude of the portions of the company's financial statements audited by the auditors.²³⁴
 - Communicate to the referred-to auditor the decision to divide responsibility for the audit with the referred-to auditor²³⁵ and determine a course of action when the lead auditor is unable to divide responsibility.²³⁶

In addition, AS 1206 establishes new requirements. For example, AS 1206 requires the lead auditor to:

- Obtain a representation from the referred-to auditor that the referred-to auditor is duly licensed to practice under the laws of the jurisdiction that apply to the referred-to auditor's work;²³⁷
- If the referred-to auditor plays a substantial role in the preparation or furnishing of the lead auditor's report, determine whether the referred-to auditor is registered with the PCAOB;²³⁸

²³³ See AS 1206.06b and AS 1205.10c(ii)–.10c(iii).

²³⁴ See AS 1206.08a and .08c, and AS 1205.07.

²³⁵ See AS 1206.04 and AS 1205.10(c)(i).

²³⁶ See AS 1206.07 (requiring the lead auditor, if it cannot divide responsibility, to plan and perform procedures necessary for it to issue an opinion, qualify or disclaim its opinion, or withdraw from the engagement) and AS 1205.11.

²³⁷ AS 1206.05b.

²³⁸ AS 1206.06c.

- Disclose the name and refer to the report of the referred-to auditor in the lead auditor's report;²³⁹ and
- Establish which auditor (lead auditor or referred-to auditor) has audited, and disclose in the lead auditor's report which auditor has taken responsibility for, the conversion adjustments in situations where the financial statements of the company's business unit audited by the referred-to auditor were prepared using a financial reporting framework that differs from the financial reporting framework used to prepare the company's financial statements.²⁴⁰

Consistent with AS 1205, a note to AS 1206.01 requires that the engagement partner in a divided-responsibility scenario determine the sufficiency of his or her firm's participation in the audit to serve as the lead auditor. This requirement appears in AS 2101.06A–.06C, discussed above.²⁴¹

The 2016 Proposal retained the divided-responsibility approach that has long been permitted in PCAOB standards²⁴² and solicited views on whether this approach should be eliminated. Most commenters 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.

²³⁹ AS 1206.08b.

²⁴⁰ AS 1206.06d.

²⁴¹ AS 2101.06A–.06C also address, among other things, the sufficiency-of-participation determination for audits subject to AS 1201.

²⁴² 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.

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.²⁴³ They stated that the lead auditor is ultimately responsible for the overall audit opinion and should not refer to other auditors.²⁴⁴

Having considered the comments received, the Board has decided to retain the divided-responsibility alternative (with certain conditions set forth in the 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, the lead auditor may be unable to plan and supervise another auditor's work if the subsidiary audited by the other auditor is acquired by the lead auditor's audit client late in a fiscal year. In this situation, the lead auditor may be unable to gain access to people (e.g., subsidiary management, other auditor's personnel) and documentation (e.g., subsidiary records, other auditor's working papers).²⁴⁵ As a result, the lead auditor may be unable to obtain sufficient appropriate audit

²⁴³ See Section III.F.1 of the 2021 SRC for a more detailed discussion of comments received (e.g., concern that a lead auditor might divide responsibility to avoid liability for its work on the audit, concern that the effectiveness of audit committee oversight could be reduced if the audit committee has no relationship with the referred-to auditor, risk of leakage of market sensitive information may increase if the referred-to auditor is involved in a corporate transaction), including the Board's responses.

²⁴⁴ 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 acknowledged that AICPA standards allow for divided responsibility. Transcript excerpts for these meetings are available in the docket for this rulemaking on the PCAOB's website, available at <https://pcaobus.org/Rulemaking/Pages/Docket042.aspx>.

²⁴⁵ See also discussion below regarding investee financial statements audited by an investee's auditor.

evidence to support an unqualified audit opinion on the company's consolidated financial statements and may determine to withdraw from the audit engagement or disclaim its opinion.

Objectives

See Appendix A of AS 2101 and paragraph .02 of AS 1206

AS 1206, unlike AS 1205 (which the Board has rescinded), discusses the following objectives of the lead auditor: (i) 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, internal control over financial reporting; and (ii) make the necessary disclosures in the lead auditor's report.²⁴⁶

Some commenters suggested revising the proposed objectives. One commenter on the 2016 Proposal suggested that the objectives should include performing procedures necessary to make reference to the report of the referred-to auditor in the lead auditor's report, and making necessary disclosures in the report. Another commenter suggested broadening the objective to cover the assessment of the referred-to auditor's independence and competence and proper communication between the lead auditor and referred-to auditor to clarify roles and responsibilities.

Having considered the comments received, the Board believes that the recommended revisions relate to details of performance and reporting rather than to high-level objectives of the standard. It also notes that the lead auditor would effectively accomplish the objectives suggested by the commenters by performing the procedures described in AS 1206.²⁴⁷ Thus, the Board adopted the standard's objectives as proposed.

²⁴⁶ See AS 1206.02.

²⁴⁷ See AS 1206.03–.07 regarding performing procedures with respect to the audit of the referred-to auditor, and AS 1206.08–.09 regarding making reference in the lead auditor's

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

Performing Procedures Regarding the Consolidation or Combination of the
Financial Statements

See paragraph .03 of AS 1206

Under AS 1206.03, 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 units²⁴⁸ audited by the referred-to auditor into the company's financial statements. Matters affecting the consolidation or combination of the financial statements typically include items that are not in the scope of the referred-to auditor's audit, such as elimination of intercompany transactions with the business unit audited by the referred-to auditor.

This provision in AS 1206 builds on and strengthens a requirement for the lead auditor in AS 1205.10 regarding adopting appropriate measures to assure the coordination of the lead auditor's activities with those of the referred-to auditor in order to achieve a proper review of matters affecting the consolidating or combining of accounts in the financial statements. Commenters did not address this proposed provision, and the Board adopted it as proposed.

report. *See also* AS 1206.05–.06 regarding certain qualifications of the referred-to auditor, and AS 1206.03–.04 regarding coordinating certain procedures with, and communicating certain matters to, the referred-to auditor.

²⁴⁸ As stated in footnote 7 of AS 1206.03, the term "business units" includes subsidiaries, divisions, branches, components, or investments.

Communicating the Plan to Divide Responsibility

See paragraph .04 of AS 1206

Under AS 1206.04, the lead auditor is required to communicate to the referred-to auditor, in writing, its plan to divide responsibility for the audit with the referred-to auditor pursuant to PCAOB standards. A referred-to auditor who has been informed of the lead auditor's plan to divide responsibility will be able to take the necessary steps to ascertain the implications of participating in the audit of the company. For example, SEC rules require that the audit report prepared by the referred-to auditor be filed with the SEC.²⁴⁹

This provision in AS 1206 builds on and strengthens a requirement for the lead auditor in AS 1205.10 regarding ascertaining that the referred-to auditor is aware of the divided-responsibility arrangement.²⁵⁰ Commenters did not address this provision, and the Board adopted it as proposed.

Requesting a Written Representation Regarding Independence and Licensing

See paragraph .05 of AS 1206

AS 1206.05a provides that the lead auditor should obtain a written representation from the referred-to auditor that the referred-to auditor is independent of the audit client under the

²⁴⁹ See Regulation S-X Rule 2-05, 17 CFR 210.2-05, which requires that, in divided-responsibility scenarios, the referred-to auditor's report be filed with the SEC. Rule 2-05 provides that if, with respect to the examination of the financial statements, part of the examination is made by an independent accountant other than the principal accountant and the principal accountant elects to place reliance on the work of the other accountant and makes reference to that effect in his report, the separate report of the other accountant must be filed. The term "principal accountant" is used in the rule. See discussion above regarding whether the term "referred-to auditor" is aligned with the term "principal accountant" used by the SEC, noting that the definitions in this rulemaking do not affect the applicability of SEC terms or rules to audits involving other auditors or referred-to auditors, including the definition of "principal accountant."

²⁵⁰ See AS 1205.10(c)(i).

requirements of the PCAOB and SEC. This provision is designed to strengthen the existing requirements regarding the lead auditor's responsibilities with respect to the independence of the referred-to auditor.²⁵¹ Commenters did not address this proposed requirement, and the Board adopted it as proposed.

AS 1206.05b provides that the lead auditor should obtain a written representation from the referred-to auditor that it is duly licensed to practice under the laws of the jurisdiction that apply to the work of the referred-to auditor. This requirement is not included in AS 1205. Commenters did not address this proposed requirement of AS 1206, and the Board adopted it as proposed.

Conditions for the Lead Auditor to Divide Responsibility, and the Lead Auditor's
Course of Action When It is Unable to Divide Responsibility

See paragraphs .06 and .07 of AS 1206

AS 1206 describes the (i) conditions that must be met for the lead auditor to divide responsibility with the referred-to auditor and (ii) lead auditor's course of action when it is unable to divide responsibility.²⁵² These provisions strengthen the requirements in AS 1205.11.²⁵³ The requirements of AS 1206, which are discussed in more detail below, are designed to facilitate compliance with PCAOB and SEC independence requirements and PCAOB registration rules,

²⁵¹ AS 1205.10 requires the lead auditor to "make inquiries" concerning the other auditor's independence, which inquiries "may include" procedures such as obtaining a representation from the other auditor that the other auditor is independent.

²⁵² *See* AS 1206.06 and .07.

²⁵³ Under AS 1205.11, the lead auditor should appropriately qualify or disclaim its opinion on the consolidated financial statements if it concludes that it can neither assume responsibility for the work of the other auditor nor divide responsibility with the other auditor.

and to reduce the likelihood of filing auditors' reports with the SEC that violate any relevant local licensing requirements.

Conditions for the Lead Auditor to Divide Responsibility

Performed an Audit and Issued an Auditor's Report in Accordance with PCAOB

Standards, and Was Registered with PCAOB (When Applicable)

Under AS 1206.06a, the lead auditor may divide responsibility with another accounting firm only if the referred-to auditor has represented that it has performed its audit and issued its auditor's report in accordance with PCAOB standards.²⁵⁴ This provision, which is not included in AS 1205, is consistent with existing SEC rules and guidance with respect to the auditors' reports filed with the SEC.²⁵⁵ Further, according to AS 1206.06c, the lead auditor may divide responsibility with another accounting firm that would play a substantial role in the preparation or furnishing of the lead auditor's report, or, if the referred-to auditor's report is with respect to a business unit that is itself an issuer, broker, or dealer, only if that firm is registered with the PCAOB.²⁵⁶

²⁵⁴ 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, apply to auditors' reports issued 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 applies to auditors' reports issued 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.

²⁵⁵ See Regulation S-X Rule 2-02(b)(1), 17 CFR 210.2-02(b)(1); SEC, Commission Guidance Regarding the Public Company Accounting Oversight Board's Auditing and Related Professional Practice Standard No. 1, Release No. 34-49708 (May 14, 2004).

²⁵⁶ See Section 102(a) of Sarbanes-Oxley, 15 U.S.C. 7212(a); PCAOB Rule 2100, *Registration Requirements for Public Accounting Firms*; paragraph (p)(ii) of PCAOB Rule 1001 (defining the phrase "play a substantial role in the preparation or furnishing of an audit report").

AS 1206 mirrors current PCAOB registration requirements. It does not establish additional criteria for registering with the PCAOB or otherwise change the registration requirements. Specifically, AS 1206 will not allow the lead auditor to divide responsibility for the audit with an unregistered public accounting firm unless that firm is not required to be registered with the PCAOB under Sarbanes-Oxley Section 102(a) and PCAOB Rule 2100.

The standard the Board adopted clarifies, in a footnote to paragraph .06, that if the referred-to auditor is not registered with the PCAOB, the requirement in AS 3101 regarding stating in the auditor's report that the auditor is registered with the PCAOB does not apply to the referred-to auditor's report.²⁵⁷ The same footnote also points out that disclosure in the referred-to auditor's report that a firm is not registered with the PCAOB (or omission of a statement that the firm is registered) does not relieve that firm of its obligation to register when required. The Board received no comments on this provision and adopted it as proposed.

Knowledge of Relevant Requirements and Standards

Under AS 1206.06b, the lead auditor may divide responsibility with the referred-to auditor only if the lead auditor determines, based on inquiries made to the referred-to auditor and other information obtained by the lead auditor during the audit, that the referred-to auditor is familiar with the relevant requirements of the applicable financial reporting framework, PCAOB standards, and SEC financial reporting requirements.

The final standard's formulation "is familiar with" was included in the 2021 SRC, modifying the earlier formulation "knows," to reflect the difference in the lead auditor's relationship with the referred-to auditor (for divided responsibility) and the other auditor (for supervision). As noted in the 2021 SRC, the lead auditor does not supervise the referred-to

²⁵⁷ See AS 3101.06 and .09g, and AS 2201.85A and .85Dd.

auditor, because the referred-to auditor is responsible for its audit of and audit report on the financial statements (and, if applicable, ICFR) of the company's business unit. The lead auditor does not take responsibility for the referred-to auditor's audit. In contrast, when an other auditor is involved in the audit, the lead auditor supervises the other auditor's work, takes responsibility for that work, and is therefore required to obtain a more in-depth understanding of the other auditors' knowledge, skill, and ability when establishing the necessary extent of supervision than for a referred-to auditor in a divided-responsibility audit.

Commenters did not address this amendment, and the Board adopted it as proposed.

Financial Reporting Framework Used to Prepare the Company's and Business Unit's Financial Statements

Under AS 1206.06d, in relatively uncommon situations when the financial statements of the company's business unit audited by the referred-to auditor are prepared using a financial reporting framework that differs from the framework used to prepare the company's financial statements, the lead auditor may divide responsibility only if (i) either the lead auditor or the referred-to auditor has audited the conversion adjustments and (ii) the auditor's report of the lead auditor indicates which auditor audited the conversion adjustments. (AS 1205, which is being rescinded, does not explicitly address these situations.)²⁵⁸ The final standard's approach was proposed in the 2017 SRC, reversing the restriction in the 2016 Proposal that would not have permitted the division of responsibility in the audit of a company whose applicable financial

²⁵⁸ PCAOB staff analyzed Form 10-K and Form 20-F filings with the SEC for the twelve-month period ended April 30, 2022. This search identified 38 divided-responsibility opinions, three of which the lead auditor divided responsibility with another auditor when the company and a business unit prepared their financial statements under different financial reporting frameworks. These filings did not state which auditor audited the conversion adjustments.

reporting framework differs from that of its business unit.²⁵⁹ The Board believes the resulting approach is practicable and balanced and adopted the provision substantially as proposed in the 2017 SRC.

Commenters on the 2017 SRC largely agreed with the revised provision, although two commenters recommended revisions. One recommended an additional requirement, that the lead auditor document its basis for concluding that the auditor of the conversion adjustments has sufficient knowledge of both reporting frameworks. Another commenter asserted that the lead auditor's disclosure of another auditor's audit of conversion adjustments could be misconstrued as a disclaimer of responsibility for that work.

With regard to the first commenter's recommendation, the Board notes that a separate documentation requirement is unnecessary because the lead auditor's compliance with the requirements relating to the referred-to auditor's knowledge of the relevant requirements is already required to be reflected in audit documentation under the existing PCAOB standards.²⁶⁰ With regard to the second commenter's argument, the Board notes that the required disclosure in the lead auditor's report would clearly identify the auditor that has taken responsibility for auditing the conversion adjustments and the PCAOB has inspection and enforcement authority over both firms.

Appendix B of AS 1206 provides 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).

²⁵⁹ See 2017 SRC at 25-26.

²⁶⁰ See, e.g., AS 1215.05a (providing that audit documentation should "[d]emonstrate that the engagement complied with the standards of the PCAOB").

Lead Auditor's Course of Action When the Lead Auditor Is Unable to
Divide Responsibility Under AS 1206

AS 1206.07 provides guidance for situations in which the lead auditor is unable to divide responsibility with another accounting firm. Such a situation may arise, for example, due to the lead auditor's concerns about the qualifications of the referred-to auditor. Concerns about the referred-to auditor's qualifications could encompass both competence and PCAOB registration status. The lead auditor may also have concerns about whether the referred-to auditor's audit was performed in accordance with PCAOB standards if, for instance, information comes to the lead auditor's attention that raises such doubt.

For situations in which the lead auditor is unable to divide responsibility for the audit with another accounting firm, paragraph .07 of AS 1206 describes the following alternatives for the lead auditor's course of action:

- Planning and performing procedures with respect to the portion of the company's financial statements covered by the other accounting firm's report that are necessary for the lead auditor to express an opinion on the company's financial statements and, if applicable, ICFR;
- Appropriately qualifying or disclaiming the lead auditor's report;²⁶¹ or
- Withdrawing from the engagement.

²⁶¹ AS 1206, in a note to paragraph .07b, requires the lead auditor to state the reasons for 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. A footnote to AS 1206.07 refers to the relevant requirements of AS 3105 and Appendix C of AS 2201.

A commenter requested that the standard state that the circumstances described in AS 1206.07 exist in situations when the lead auditor originally expected to divide responsibility with the referred-to auditor but subsequently determined that it was no longer possible. This commenter also stated that AS 1206.07, as proposed, limits the lead auditor's course of action to the three options presented and recommended that another option be added whereby the work would be performed by another accounting firm.

The Board agrees that AS 1206.07 applies only in situations when the lead auditor originally expected to divide responsibility with another accounting firm but subsequently determined that dividing responsibility with that accounting firm was no longer possible. Further, the Board notes that the course of action suggested by the commenter (i.e., having another accounting firm perform the work) is already available to the lead auditor under AS 1206.07a, as a lead auditor that complies with the relevant requirements of PCAOB standards is permitted to plan and perform procedures with respect to the business unit itself, divide responsibility for that work with another referred-to auditor, or supervise and assume responsibility for the work of an other auditor.

No further comments were received on this topic and the Board adopted the requirement substantially as proposed.

Making Reference in the Lead Auditor's Report to the Referred-to Auditor's Audit and Report

See paragraphs .08 and .09 of AS 1206

Enhanced Requirements for Making Reference

Paragraphs .08 and .09 of AS 1206 establish requirements for making reference in the lead auditor's report to the audit and auditor's report of the referred-to auditor.²⁶² Because this rulemaking generally carries forward, with certain modifications, AS 1205's provisions for divided-responsibility audits, the requirements for making reference in AS 1206 are similar to the analogous provisions of AS 1205. For example, similar to AS 1205, AS 1206 requires that the lead auditor's report (or reports, if the lead auditor chooses to issue separate reports on the company's financial statements and internal control over financial reporting):

- Indicate clearly, in the Opinion on the Financial Statements and, if applicable, Internal Control over Financial Reporting and Basis for Opinion sections, the division of responsibility between the portion of the company's financial statements and, if applicable, ICFR, covered by the lead auditor's own audit and that covered by the audit of the referred-to auditor;²⁶³ and
- Disclose the magnitude of the portion of the company's financial statements and, if applicable, ICFR, audited by the referred-to auditor (or by each of the referred-to auditors if there is more than one). This may be done by stating the dollar amounts or percentages of total assets, total revenues, or other appropriate criteria necessary to

²⁶² In addition, Appendix B of AS 1206 includes examples of reporting by the lead auditor (Examples 1 through 4). The Board's consideration of certain aspects of the examples are discussed below. In addition, the examples consider the requirements of AS 3101 and AS 3501. Those standards were approved by the SEC after the issuance of the 2016 Proposal. *See* SEC Release No. 34-81916 (Oct. 23, 2017).

²⁶³ *See* AS 1206.08a.

identify the portion of the company's financial statements audited by each of the referred-to auditors.²⁶⁴

If the report of the referred-to auditor includes an opinion other than an unqualified opinion or includes explanatory language, AS 1206, similar to AS 1205, requires that the lead auditor make reference in the lead auditor's report to the departure from the unqualified opinion and its disposition, or the explanatory language, or to both, unless the matter is clearly trivial to the company's financial statements.²⁶⁵ AS 1206 does not require that the lead auditor's report make reference to critical audit matters (CAMs) of the referred-to auditor, as each auditor must determine whether there are any CAMs arising from its own audit under AS 3101.

A commenter questioned whether, under AS 1206.08c, the magnitude of the portion of the company's financial statements audited by the referred-to auditor needs to be disclosed for each referred-to auditor individually. The commenter asserted that in practice the lead auditors' reports generally disclose the magnitude of the referred-to auditors' portions of the company's financial statements, and if applicable ICFR, in combination (not for each referred-to auditor). The commenter therefore recommended that the Board modify the requirement in line with the commenter's understanding of current practice.

The Board believes that the lead auditor's report should disclose the magnitude of the portion of the company's financial statements and if applicable, ICFR, individually for each referred-to auditor. In addition to providing greater transparency to investors and other users of

²⁶⁴ See AS 1206.08c. See also second note to AS 1206.01, which states when there is more than one referred-to auditor, the lead auditor must apply the requirements of AS 1206.03–.09 in relation to each of the referred-to auditors individually.

²⁶⁵ See AS 1206.09. See also note to paragraph .10 of AS 2810, *Evaluating Audit Results* (describing "clearly trivial").

the lead auditor's report about accounting firms involved in the audit and their responsibilities, the individual disclosure approach is not inconsistent with divided-responsibility reporting observed in practice. Based on a staff analysis of SEC filings, most lead auditor opinions that refer to multiple referred-to auditors disclose the magnitude of the referred-to auditors' portions of the company's financial statements individually.²⁶⁶ The amendments state in the second note to AS 1206.01 that the requirements in paragraphs .03–.09 must be applied to each referred-to auditor individually.

The same commenter suggested replacing the proposed "and" (before the phrase "other appropriate criteria") in the last sentence of AS 1206.08c with "or" to indicate that not all magnitude criteria need to be disclosed. The Board agrees that under AS 1206 the magnitude may be expressed by using the criteria listed in paragraph .08c, but does not require using all criteria. Complying with AS 1206 involves using criteria that are necessary to provide a clear and informative disclosure in the lead auditor's report of the magnitude of the portion of the company audited by the referred-to auditors, and that may require disclosure of more than one criterion in some cases. To enhance clarity, the Board replaced the term "and" with "or" as suggested by the commenter.

The Board considered these comments and determined that the remaining requirements were sufficiently clear and adopted them as proposed.²⁶⁷

²⁶⁶ PCAOB staff analyzed Form 10-K and Form 20-F filings with the SEC for the twelve-month period ended April 30, 2022. This search identified 38 divided-responsibility opinions, two of which made reference to multiple-divided-responsibility audits. Both of those opinions presented the magnitude disclosures disaggregated.

²⁶⁷ Paragraph .09 was modified from the version in the 2017 SRC by: using the terminology in AS 3101 (which was amended by the PCAOB in 2017); adding a footnote reference to the relevant requirements of AS 3101, AS 3105, and AS 2201; and referencing a

Identifying the Referred-to Auditor by Name

To enhance the clarity of disclosure to investors and other users of the lead auditor's report, the Board adopted a new requirement in AS 1206.08b to identify the referred-to auditor by name in the lead auditor's report. SEC rules already require that the auditor's report of the referred-to auditor be filed with the SEC, so the name of the referred-to auditor is already made public.²⁶⁸

Three commenters on the 2016 Proposal and 2021 SRC objected to the proposed disclosure, because the reader can obtain the referred-to auditor's name from the referred-to auditor's report filed with the SEC or from Form AP filed with the PCAOB.²⁶⁹ Having considered these comments, the Board notes that the new provision – which builds on the existing disclosure of referred-to auditor responsibilities in the lead auditor's report, without imposing any significant compliance burden on the lead auditor – will provide interested parties a more convenient mechanism for obtaining names of the referred-to auditors, whose responsibilities, but not names, have long been disclosed in the lead auditor's report.

Other Considerations Relating to Making Reference

Some commenters on the Proposal and the 2017 SRC suggested addressing, in the reporting examples provided in AS 1206, situations in which the lead auditor issues separate reports on the financial statements and ICFR. Having considered the comments received, the

footnote in AS 1206.06 that addresses certain situations where the referred-to auditor is not registered with the PCAOB (as discussed above regarding conditions for dividing responsibility).

²⁶⁸ See Rule 2-05 of Regulation S-X, 17 CFR 210.2-05.

²⁶⁹ Registered public accounting firms must report to the Board on Form AP, pursuant to PCAOB Rule 3211, regarding the participation of other public accounting firms in the audit. Form AP disclosure applies to scenarios when responsibility for the audit is divided.

Board included in the 2021 SRC an example of separate financial statement reporting in Appendix B of AS 1206 (Example 2). The Board received no comments on this example and adopted it as proposed. In addition, in the 2021 SRC, the Board modified the reporting examples to reflect the amendments to AS 3101 that were approved by the SEC after the issuance of the 2017 SRC.²⁷⁰ The examples as adopted include these modified examples.

Other Matters

Investee Financial Statements Audited by an Investee's Auditor

See paragraphs .B1–.B2 of AS 1105

In some audits, auditors other than the firm issuing the auditor's report on the company's financial statements 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 (i.e., investees' auditors). 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 auditor²⁷¹ using the work and reports of other auditors under AS 1205.

Under the amendments, in equity method investment situations, the investor's auditor would look to the requirements of Appendix B of AS 1105, *Audit Evidence*, which describe the auditor's responsibilities for obtaining sufficient appropriate evidence in situations in which the

²⁷⁰ See SEC Release No. 34-81916 (Oct. 23, 2017).

²⁷¹ "Principal auditor" is used in AS 1205.

valuation of an investment is based on the investee's financial results.²⁷² Thus, under the amendments, the investor's auditor would be able, where appropriate, to use the work and report of the investee's auditor.

The amendments add to Appendix B of AS 1105 certain relevant provisions currently included in AS 1205,²⁷³ to further guide auditors in equity method investment circumstances. First, the amendments refer to the independence of the investee's auditor as an item for the investor's auditor to consider in determining whether the investee's auditor's report is satisfactory. 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 amendments 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. AS 2101.06b requires the auditor to determine compliance with independence and ethics requirements.²⁷⁴

Second, the amendments refer to the professional reputation or independence of the investee's auditor as an item for the investor's auditor to consider in determining whether it needs additional evidence regarding the investee's financial results. Under existing AS 1105.B2, if in the auditor's judgment additional evidence is needed concerning the investment, the auditor

²⁷² See Appendix B of AS 1105. See also Auditing Accounting Estimates, Including Fair Value Measurements and Amendments to PCAOB Auditing Standards, PCAOB Release No. 2018-005 (Dec. 20, 2018).

²⁷³ See AS 1205.10.

²⁷⁴ 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).

should perform procedures to gather evidence. The amendments add the investor's auditor's "concerns about the professional reputation or independence of the investee's auditor" to the list of examples 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 amendments do 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, for example, to use its own staff to perform procedures or seek assistance from the investee's auditor and supervise the investee's auditor's work under AS 1201. The 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 new standard AS 1206 would apply.

Several commenters were supportive of the proposed amendments for investee auditors, with some noting that the requirements provide a reasonable approach, while not being too prescriptive to allow for the investor auditor to make judgments. One commenter suggested that the Board define the term "investee auditor" and clarify in the rule text that the investee auditor is not considered an "other auditor." This commenter stated that this point is explicit in the release but not apparent in the proposed amendments. Another commenter expressed concern that the proposed terms and definitions in the rulemaking, including the term "investee's auditor," are fairly prescriptive and may be out of date after the Board adopts a final standard.

The Board considered these comments in adopting the amendments. The term investee's auditor pertains to a concept that is not new and is consistent with the terminology already in the standard,²⁷⁵ and the Board does not believe that the term should be revised or eliminated. With

²⁷⁵ See AS 1105.B3, which uses the term "investee auditor's report."

regard to the comment that the Board should define the term investee auditor and clarify that the investee auditor is not considered an other auditor, it is possible that an investor's auditor may decide that it is able to supervise an investee's auditor under AS 1201, having considered the factors in AS 2101.12. In that situation, the investee's auditor could be considered an other auditor under the amendments.

Another commenter suggested that, in the situation involving an investee's auditor, sufficient appropriate audit evidence cannot be obtained through simple evaluation of sufficiency of the investee's financial statements and results. This commenter suggested that additional procedures may be required, such as the investor's auditor obtaining an understanding of the investee's control environment as well as performing an evaluation or assessment of prior audit risks and business, financial, and market risks, including how those risks have been managed by the investee. As noted in the 2021 SRC, 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 inform, direct, and review work performed by the investee's auditor or obtain information from investee management. Therefore, while obtaining an understanding of the investee's control environment may be beneficial in certain cases, access issues may prevent it.

Further, the SEC staff has previously clarified that ICFR of an equity method investee is not part of the investor's internal control over financial reporting²⁷⁶ and therefore not part of the assessments required under Sections 404(a) and 404(b) of the Sarbanes-Oxley Act of 2002.

²⁷⁶ See SEC Staff FAQ on <https://www.sec.gov/info/accountants/controlfaq.htm> – Question 2. Under this approach, while ICFR related to an investee's financial reporting is out-of-scope, internal control over financial reporting related to an investor's recording of amounts associated with its investment is in-scope.

Lastly, depending on the financial reporting framework of the investee, financial and market risks may be required to be disclosed within the financial statements. The Board believes that these disclosure requirements, if complied with, should be sufficient in some cases of equity method investees to contribute to an investor's auditor obtaining sufficient appropriate evidence. The Board agrees with the commenter that there may be situations in which further understanding by the investor's auditor of ICFR or the risks of the investee would be necessary. The Board notes that the amendments are principles-based and can be used to appropriately determine the necessary procedures for obtaining sufficient appropriate audit evidence.

A commenter requested clarification regarding a statement made in the 2021 SRC that AS 2101.06b requires the investor's auditor to determine compliance with independence and ethics requirements of the investee's auditor. It is not the Board's intent to change practice with these amendments, but it should be noted that the investor's auditor remains responsible for determining compliance with independence and ethics requirements for the entire audit, including work performed by the investee's auditor. The Board believes that an investor's auditor should determine whether the report of the investee's auditor is satisfactory and may consider performing procedures, such as making inquiries as to the investee's auditor's independence in making this determination.

Footnote 1 to AS 1105.B1 discusses procedures that the investor's auditor may consider performing to determine whether the investee's auditor's report is satisfactory. One commenter suggested replacing the word "visiting" in the phrase "visiting the investee's auditor" with the phrase "interacting (e.g., using video conferencing technology or visiting the other auditor)

with."²⁷⁷ The commenter offered this alternate phrasing to recognize the current practice of using technology for remote access. Having considered the comment, the Board adopted the amendments as proposed. The word "visiting" should not be interpreted as requiring a physical visit or as precluding a virtual visit through the use of technology. Additionally, the Board noted that the procedures in footnote 1 to AS 1105.B1 use the qualifier "may consider performing;" thus, the determination of the procedures to perform is at the discretion of the investor's auditor.

Another commenter opined that the amendments do not adequately address the nature and extent of work to be performed by the investor's auditor, including the lack of consideration of knowledge, skill, and ability of the investee's auditor, and noted that the standard used "reputation" as a consideration in footnote 1 to AS 1105.B1. Access to the investee's auditor is likely to impact an investor's auditor's ability to evaluate the knowledge, skill, and ability of an investee's auditor. In addition, under the circumstances, inquiries about the reputation and standing of the investee's auditor²⁷⁸ may uncover issues regarding the professional competence of the investee's auditor. Two commenters raised the issue of non-coterminous year ends, which one of the commenters characterized as "a common problem," and noted a lack of clarity about the nature and extent of work to be performed by an investor's auditor in this situation, particularly with respect to competence, independence, and oversight of an investee's auditor.

²⁷⁷ As proposed and as the Board adopted, footnote 1 to AS 1105.B1 states: "In determining whether the report of the investee's auditor is satisfactory for this purpose, the auditor may consider performing procedures such as making inquiries as to the professional reputation, standing, and independence of the investee's auditor (under the applicable standards), visiting the investee's auditor and discussing the audit procedures followed and the results thereof, and reviewing the audit program and/or working papers of the investee's auditor." (emphasis added).

²⁷⁸ See footnote 1 to AS 1105.B1.

One of these commenters also raised the issue of differing reporting frameworks and auditing standards.

The Board noted that the amendments are based on certain principles relating to the auditor's responsibility for obtaining sufficient appropriate audit evidence. The amendments are designed to be flexible, considering a variety of situations that exist in practice involving an investee's auditor. For example, in situations of non-coterminous year-ends, U.S. GAAP and IFRS allow for a consistent time lag between the fiscal year-ends of the investor and its equity method investees, which time lag would be reflected in the financial statements of the investor.²⁷⁹ The amendments require obtaining sufficient appropriate audit evidence in support of the investee's financial results, and provide examples of procedures that may need to be performed in addition to reviewing the investee's auditor's report. With regard to differing auditing standards, the investor's auditor is responsible for planning and performing – in compliance with PCAOB standards – the audit of the investor's financial statements (and, if applicable, internal control over financial reporting), including determining what constitutes sufficient appropriate audit evidence.

After considering all of these comments, the Board adopted the amendments as proposed.

Audit Documentation

See paragraphs .18–.19 to AS 1215

Under existing AS 1215.18, the office of the firm issuing the auditor's report is responsible for ensuring that all audit documentation sufficient to meet the relevant requirements

²⁷⁹ See Financial Accounting Standards Board Accounting Standards Codifications, Subtopic 323-10, *Investments—Equity Method and Joint Ventures*, paragraph 10-35-6. See also International Accounting Standards Board International Accounting Standard 28, *Investments in Associates and Joint Ventures*, paragraph 34.

is prepared and retained.

As noted above, the amendments reinforce existing responsibilities of the other auditor to perform work with due care and in compliance with PCAOB standards. Specifically with respect to audit documentation, an amendment to AS 1215.18 reiterates that other auditors must comply with existing documentation requirements, specifically 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. Additionally, the amendments to AS 1215.18–.19 conform terminology relating to the use of the newly defined term "other auditor."²⁸⁰

A commenter on the 2021 SRC was supportive of the changes proposed in AS 1215.18 while another commenter suggested that the term "other offices of the firm" be revised in paragraphs .18–.19 to use another term to clarify that this concept should be applied to offices that are not the office of the firm issuing the auditor's report. The Board considered this comment and determined that the requirements proposed are sufficiently clear, and adopted the requirements as proposed.

Engagement Quality Review – Amendment to AS 1220

See paragraph .10a of AS 1220

Existing PCAOB standards specify certain procedures the engagement quality reviewer should perform in evaluating the significant judgments made by the engagement team and the related conclusions reached in forming the overall conclusion on the engagement and in

²⁸⁰ See discussion above. In footnote 4 of AS 1215.18, the final amendments do not include the proposed phrase "in certain circumstances" after the words "other related documents" because it is superfluous.

preparing the engagement report.²⁸¹ In addition, the amendments to AS 1220 require the engagement quality reviewer, in an audit involving other auditors or referred-to auditors, to evaluate the engagement partner's determination that the participation of the 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 and, if applicable, ICFR.²⁸²

Some commenters supported the amendment, while others opposed it, contending that the sufficiency-of-participation determination is not always a significant judgment and thus does not always warrant evaluation by the engagement quality reviewer. Having considered the comments received, the Board adopted the requirement as proposed. Although determining the sufficiency of a firm's participation in the audit might not always be difficult or complicated, the decision that the firm can serve as lead auditor is always a significant judgment because it affects whether it is appropriate for the firm to issue the audit report.²⁸³ Therefore, evaluating the sufficiency-of-participation determination is important for the engagement quality reviewer's conclusion about whether the lead auditor's report is appropriate in the circumstances of a particular audit.²⁸⁴

Conforming Amendments and Other Relevant Considerations

This section discusses conforming amendments and other considerations where significant comment was received as part of this rulemaking. The proposed rule text includes

²⁸¹ See AS 1220.09.

²⁸² The corresponding requirements for the engagement partner are in AS 2101.06A–.06C. The amendments added a reference to these requirements and to the definitions of lead auditor, other auditor, and referred-to auditor in AS 2101, in a footnote to AS 1220.10a.

²⁸³ See AS 2101.06A.

²⁸⁴ See AS 1220.12.

conforming amendments discussed in this section and other conforming amendments to PCAOB auditing standards, auditing interpretations, attestation standards, rules, and Form AP.

Communications with Audit Committees

See paragraph .10e of AS 1301

The 2021 SRC proposed to conform terminology in paragraph .10d of AS 1301, *Communications with Audit Committees*, with new definitions. In particular, the standard would have used "other auditors" in lieu of "independent public accounting firms or persons, who are not employed by the auditor." Upon further consideration, the Board determined that the proposed amendment might not be consistent with the original intent of the requirement to communicate all participants in the audit to the audit committee.²⁸⁵

The change proposed in the 2021 SRC could have excluded, for example, individuals who work at shared service centers and are supervised by an other auditor, as these individuals would be subsumed by the replacement term "other auditor." To avoid unintended outcomes, the Board did not amend AS 1301.10d.

Separately, the Board made a conforming change to AS 1301.10e to add "referred-to auditors" to the phrase "if significant parts of the audit are to be performed by other auditors." The 2017 SRC²⁸⁶ restored the existing phrase in AS 1301.10e, "if significant parts of the audit are to be performed by [other auditors]," that would have been removed by the 2016 Proposal. No subsequent comment was received in this area, and the Board adopted the amendment to AS 1301.10e as proposed in the 2017 SRC.

²⁸⁵ See Auditing Standard on Communications with Audit Committee and Related Amendments to PCAOB Standards, PCAOB Release No. 2012-004 (Aug. 15, 2012).

²⁸⁶ See 2017 SRC at 37.

Certain Required Interactions with the Referred-to Auditor

See paragraph .53 of AS 2401

The amendments to paragraph .53 of AS 2401, *Consideration of Fraud in a Financial Statement Audit*, conform terminology by replacing "other independent auditor" with "other auditors or referred-to auditors." The amendments also replace "subsidiaries, divisions or branches" with "locations or business units, where applicable." Further, the amendments include two new footnotes that refer to the definitions of "engagement team" and "referred-to auditor" in Appendix A of AS 2101, as well as clarify the term "business units," used in the revised paragraph.

A commenter stated that this amendment would go beyond current practice for the division of responsibility. Having considered the commenter's view, the Board adopted the amendments to AS 2401 substantially as proposed.²⁸⁷ The Board believes that the amendment does not substantively change the example in AS 2401.53, but merely updates the terminology, aligning it with other amendments in this release.

Amendments Relating to Certain Inquiries and Procedures Concerning Another Auditor

Several PCAOB standards refer to AS 1205.10–.12 when describing certain inquiries and procedures concerning another auditor²⁸⁸ whose audit report is used as audit evidence in the audit of a company's financial statement (such as the audit report of a service auditor or predecessor auditor). In the majority of these circumstances, the auditor whose report is used in this manner

²⁸⁷ The final amendments include "locations or business units, where applicable," instead of only the term "business units."

²⁸⁸ Such inquiries include inquiring about professional reputation and reviewing the work of another auditor.

is neither supervised by the lead auditor under AS 1201 nor serving as another independent auditor under AS 1205.²⁸⁹

These amendments are amending the standards that refer to rescinded AS 1205.10–.12 by incorporating the relevant statements from those paragraphs into the text of the standards, as was the approach in the 2016 Proposal. The Board discussed comments received on the 2016 Proposal in the 2017 SRC and made no modifications to the proposed amendments.²⁹⁰

A commenter on the 2021 SRC believed that the conforming amendment to AS 2601.19 would result in a change to the meaning and related user auditor performance requirement. This commenter suggested revisions to the language to highlight that the user auditor "may give consideration to" performing the procedures. The Board believes that the conforming amendment does not change the meaning of the requirement, and that it is sufficiently clear.²⁹¹ The amendment states that "the user auditor should consider performing one or more of the [listed] procedures." This language is incorporated in several locations, *e.g.*, AS 2201.B23; paragraphs .18–.19 of AS 2601, *Consideration of an Entity's Use of a Service Organization*; footnote 8 to paragraph .12 of AS 2610, *Initial Audits—Communications Between Predecessor and Successor Auditors*; and AS 3105.55.

The Board adopted the amendments as proposed.

²⁸⁹ Under rescinded AS 1205, for these circumstances the auditor who uses the audit may be in a position analogous to that of a principal auditor. *See, e.g.*, AS 1205.14.

²⁹⁰ *See* 2017 SRC at 35.

²⁹¹ The Board does not view the phrase "should give consideration" in existing AS 2601.19 as being different from "should consider," which is the terminology used in auditing and related professional practice standards as defined in PCAOB Rule 3101.

Rescinding AI 10, Part of the Audit Performed by Other Independent Auditors: Auditing Interpretations of AS 1205

The amendments (i) rescind AI 10, the auditing interpretations of AS 1205; and (ii) carry forward, with modifications, as an amendment to AS 2110, a provision in AI 10 that the other accounting firm should consider inquiring of the lead auditor about matters that may be significant to the other accounting firm's own audit (e.g., executive compensation arrangements).²⁹²

Situations in which the lead auditor divides responsibility for the audit with a referred-to auditor are governed by the new standard, AS 1206. The new standard requires, among other things, that the lead auditor communicate with the referred-to auditor and determine that audit procedures are properly performed, in coordination with the referred-to auditor, with respect to the consolidation or combination of the financial statements of the business units audited by the referred-to auditor into the company's financial statements. For situations in which the lead auditor supervises the work of the other accounting firm, the other auditor's inquiry of the lead auditor is addressed by existing standards.²⁹³ For situations in which the lead auditor divides responsibility for the audit with the other accounting firm, an amendment to AS 2110 carries forward, with modifications, the existing requirement in AI 10 for the referred-to auditor's inquiries of the lead auditor as to matters that may be significant to the referred-to auditor's own audit.²⁹⁴

²⁹² See AI 10.04–.07; see also new paragraph .11A to AS 2110 in this document. The modifications address the format and terminology.

²⁹³ See, e.g., AS 2110.49–.51, which require discussion among engagement team members throughout the audit about significant matters affecting risks of material misstatement.

²⁹⁴ The Board corrected a footnote number in paragraph .28A of AS 2110. This footnote was incorrectly numbered as 16A in a previous rulemaking release, *Amendments to*

Some commenters on the 2016 Proposal viewed rescinding AI 10 as appropriate, and some others suggested carrying forward all or certain portions of the guidance in AI 10, including the amendment the Board is making to AS 2110. A commenter on the 2021 SRC stated that the conforming amendment to AS 2110.11A was not consistent with the provisions of existing AS 1205.10 since, it asserted, AS 2110.11A goes beyond current practice. The Board rescinded AI 10, as originally proposed. The AI 10 direction for the lead auditor is based on the limited procedures in AS 1205, which the Board rescinded. The provision addressed to the referred-to auditor in AI 10.04–.07 was carried forward to AS 2110.11A, as noted above.²⁹⁵

Interim Reviews

See paragraphs .18b, .39–.40, and .52 of AS 4105

The Board adopted conforming amendments to AS 4105, *Reviews of Interim Financial Information*. The 2016 Proposal included conforming amendments to that standard²⁹⁶ and requested comment on whether additional changes to the standards were needed for reviews of interim financial information that involve other auditors or referred-to auditors.²⁹⁷ Three commenters who responded to this question briefly expressed support for addressing interim reviews in the amendments but did not specify any recommended changes. Another commenter

Auditing Standards for Auditor's Use of the Work of Specialists, PCAOB Release No. 2018-006 (Dec. 20, 2018), and it is being changed to 16C to reflect correct sequential numbering of footnotes. This change does not affect the content of the footnote.

²⁹⁵ In addition to the new paragraph, .11A, in AS 2110, *see* above for technical amendments to (i) AS 2110.13 and .28A (changing the numbering of two footnotes, to eliminate duplication) and (ii) AS 2110.64 (adding a footnote reference to AS 2101.11 and .12, to highlight relevant existing requirements for multi-location engagements).

²⁹⁶ *See* 2016 Proposal at A3-32.

²⁹⁷ *See* Question 58 in the 2016 Proposal at A4-62.

stated that any additional requirements should be scalable because the scope of an interim review is substantially less than that of an audit.

The 2017 SRC discussed the comments received on this topic, stated the Board's intent to adopt conforming amendments to AS 4105, and asked for any additional comment.²⁹⁸ No further comments were submitted on this topic in response to the 2017 SRC or 2021 SRC.

Having considered the comments received, the Board adopted conforming amendments to AS 4105 to appropriately reflect changes to other PCAOB standards in this rulemaking and preserve the scalable approach to interim reviews. The conforming amendments have been revised from the form in which they were proposed in 2016. As adopted, footnote 11 to AS 4105.18b clarifies that, if an accountant (i.e., auditor) who conducts a review of interim financial information obtains a report from another accountant engaged to conduct a review of interim financial information of significant components of the reporting entity or its other business units, the accountant that obtains the report is ordinarily in a position similar to that of, as applicable, (i) a lead auditor that obtains the results of the work of an other auditor (*see generally* AS 1201 (audit supervision) and AS 2101 (audit planning)) or (ii) an investor's auditor that obtains a report from an investee's auditor (*see generally* Appendix B of AS 1105 (audit evidence)).

Application to Audits of Brokers and Dealers

The amendments, if approved by the SEC, will apply to audits of brokers and dealers as defined in Sections 110(3)-(4) of Sarbanes-Oxley.²⁹⁹ The proposing releases solicited comment

²⁹⁸ See 2017 SRC at 36.

²⁹⁹ For attestation engagements in conjunction with Exchange Act Rule 17a-5, 17 CFR 240.17a-5, the supervision requirements of Attestation Standard No. 1, *Examination Engagements Regarding Compliance Reports of Brokers and Dealers*, or Attestation Standard No. 2, *Review Engagements Regarding Exemption Reports of Brokers and Dealers*, apply to the

on such applicability. No commenters opposed, and several commenters supported, applying the amendments to audits of brokers and dealers. In response to the 2021 SRC, one commenter said that it was not aware of any strong arguments that would indicate that the audits of brokers and dealers should be excluded from the application of the proposed amendments, and the commenter expressly supported applying the proposed amendments to audits of brokers and dealers. One commenter said that it did not believe that the revisions discussed in the 2021 SRC presented specific issues regarding audits of brokers and dealers.

As the Board noted in the 2016 Proposal, the auditing standards that currently govern the use of other auditors and referred-to auditors in audits of brokers and dealers are the same as those for audits of issuers. The application of the amendments to audits of brokers and dealers will continue this approach.

Staff analysis of PCAOB inspections data for audits of brokers and dealers indicates that there are no brokers or dealers that are currently issuers, although some of the largest brokers and dealers are subsidiaries of issuers. Information from PCAOB inspections and from annual reports filed by registered firms indicates that other auditors played a substantial role³⁰⁰ in a small number of audits of brokers and dealers.³⁰¹ Further, information obtained by PCAOB staff

supervision of the work of other auditors. *See Standards for Attestation Engagements Related to Broker and Dealer Compliance or Exemption Reports Required by the U.S. Securities and Exchange Commission and Related Amendments to PCAOB Standards*, PCAOB Release No. 2013-007, at A4-30 (Oct. 10, 2013).

³⁰⁰ See PCAOB Rule 1001(p)(ii) (defining the phrase "play a substantial role in the preparation or furnishing of an audit report").

³⁰¹ Firms that conduct non-issuer audits in accordance with PCAOB standards, including audits of brokers and dealers reporting under Exchange Act Rule 17a-5, are not required to file a report on Form AP regarding such audits. *See Staff Guidance: Form AP, Auditor Reporting of Certain Audit Participants, and Related Voluntary Audit Report Disclosure Under AS 3101, The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion* (Dec. 17, 2021), at 3. Thus, unlike in the case of audits of issuers

has not identified any audits of brokers and dealers in which the lead auditor divided responsibility for the audit with another accounting firm.

The Board's determination that the amendments will apply to audits of brokers and dealers is based on the observation that auditing plays a key role in enhancing the reliability of financial information provided by brokers and dealers, which is important to investor protection. The audit of brokers and dealers is intended to mitigate problems related to information asymmetry between customers of brokers and dealers, who use the services of brokers and dealers to invest in securities and other financial instruments, and management of brokers and dealers, who prepare financial information. This information asymmetry between customers and management of brokers and dealers may be significant. Customers of brokers and dealers are likely to be numerous, geographically distributed, and not expert in the management or operation of brokers and dealers. This information asymmetry makes the role of auditing important in enhancing the reliability of financial information. In addition, the audit of brokers and dealers may also help attenuate information asymmetry between management of brokers and dealers and other users of financial statements, such as counterparties and regulatory authorities.

The amendments are not expected to have a widespread impact on the audits of brokers and dealers that are not subsidiaries of issuers, since there are likely few instances in which such audits involve the use of other auditors. However, in those instances in which other auditors are used, the expected improvements in audit quality described above will benefit the customers of the broker or dealer, along with investors and the capital markets. Because of the scalability of

(including EGCs), Form AP data on the extent of use of other auditors and referred-to auditors in audits of brokers and dealers is not available.

the risk-based requirements, the costs of performing the procedures are unlikely to be disproportionate to the benefits of the procedures.

Effective Date

The Board has determined that the amendments will take effect, subject to approval by the SEC, for audits of financial statements for fiscal years ending on or after December 15, 2024.

In the proposing releases, the Board sought comment on the amount of time auditors would need before the proposed amendments would become effective, if adopted by the Board and approved by the SEC. A number of commenters on the 2021 SRC recommended that the Board provide an effective date at least two years after Board adoption and SEC approval. Some preferred, if SEC approval were to occur in the last half or quarter of the year, an effective date at least three years afterwards. In support of the time needed before effectiveness, commenters offered that audit firms will need enough time to implement the amended standards throughout the firm (such as through methodology, tools, guidance, quality control system changes, and training) and to discuss and coordinate implications of the amendments with other auditors and referred-to auditors. Some commenters also stated that because the amendments relate to matters that occur at the beginning of the audit, the implementation needs to occur before the beginning of the fiscal year of the financial statements to be audited.

The Board recognized the preferences expressed by commenters. It also appreciated the efforts already undertaken by many audit firms to raise their standards of practice in advance of the adoption of these amendments. The effective date the Board adopted is designed to provide

all auditors with a reasonable period of time to implement the amendments, without unduly delaying the intended benefits resulting from these improvements to PCAOB standards.³⁰²

D. Economic Considerations and Application to Audits of Emerging Growth Companies
Economic Analysis

The Board is mindful of the economic impacts of its standard setting. This economic analysis describes the economic baseline, economic need, expected economic impacts of the amendments, and alternative approaches considered. Because there are limited data and research findings available to estimate quantitatively the economic impacts of the amendments, the Board's economic discussion is qualitative in nature. However, where practicable, the analysis incorporates quantitative information, including analysis of Form AP data and PCAOB inspections findings.

The Board sought information relevant to the economic analysis over the course of this rulemaking.³⁰³ To the extent that commenters expressed views related to the economic analysis, commenters generally found the economic analysis in the 2016 Proposal and the discussion of economic topics in the 2017 and 2021 SRCs to be reasonable. Commenters did not provide additional quantitative data or research that could be used in the analysis. The Board considered all comments received and has developed the following economic analysis that evaluates the expected benefits and costs of the final amendments, discusses potential unintended consequences, and facilitates comparison to alternative actions considered.

³⁰² See Auditing Accounting Estimates, Including Fair Value Measurements and Amendments to PCAOB Auditing Standards, PCAOB Release No. 2018-005 (Dec. 20, 2018) (providing an effective date approximately one year after PCAOB adoption); Amendments to Auditing Standards for Auditor's Use of the Work of Specialists, PCAOB Release No. 2018-006 (Dec. 20, 2018) (same).

³⁰³ See 2016 Proposal at 30-49; 2017 SRC at 42; 2021 SRC at 62.

Baseline

The discussion above describes current PCAOB standards that apply specifically when other auditors and referred-to auditors participate in an audit and the influence of other standard setters on audit practice in this area. This section expands on that discussion by describing the economic baseline against which the impact of the amendments can be considered. Specifically, this section:

- Discusses the extent of the use of other auditors and referred-to auditors by analyzing data in AuditorSearch, which is the PCAOB's public Form AP database.³⁰⁴
- Summarizes auditing practices related to the use of other auditors and referred-to auditors, including PCAOB staff analysis of audit firm methodologies and data on deficiencies in audits that involve other auditors.
- Provides a concise survey of academic research on the use of other auditors and its impact on audit quality.

Extent of the Use of Other Auditors and Referred-to Auditors

As discussed in the 2016 Proposal, many companies have significant operations in jurisdictions outside the country or region of the lead auditor.³⁰⁵ Audits of such multinational businesses often require the participation of accounting firms other than the lead auditor and can

³⁰⁴ See <https://pcaobus.org/resources/auditorsearch>. See also 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 terms "other auditors" and "referred-to auditors" in the analysis presented in this section refer only to accounting firms.

³⁰⁵ See 2016 Proposal at 6.

often involve multiple other firms.³⁰⁶ The use of other auditors is also more prevalent in audits of larger companies audited by larger accounting firms.³⁰⁷ In addition, work performed by other auditors can comprise a significant share of a given audit.³⁰⁸

Observations in the 2016 Proposal regarding the use of other auditors and referred-to 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 accounting firms in audits on PCAOB's Form AP. Figures 2, 3, and 4 present staff analysis of Form AP filings between January 1, 2021, and December 31, 2021, and update similar information presented in the 2021 SRC.³⁰⁹

³⁰⁶ *See id.* at 6 note 4.

³⁰⁷ *See id.* at 7.

³⁰⁸ *See id.* at 6-7 and note 5 (noting that in audits selected by the PCAOB for inspection in 2013 and 2014 that involved other auditors, the other auditors audited on average between one-third and one-half of the total assets and total revenues of the company being audited).

³⁰⁹ *See* 2021 SRC at 49-55 (providing data based on Form AP filings in 2020). The analysis of Form AP data presented in Figures 2, 3, and 4 is limited to issuers other than investment company vehicles and employee benefit plans.

Figure 2. Extent of Use of Other Auditors (2021)

	Percentage of audits that use other auditors	Maximum number of other auditors used in an audit
All issuer audits	26%	63
By audit firm type³¹⁰		
U.S. GNF	39%	27
Non-U.S. GNF	58%	63
U.S. NAF	7%	10
Non-U.S. NAF	13%	17
By issuer domicile		
U.S. issuers	23%	27
Non-U.S. issuers	41%	63
By issuer size		
Fortune 500 issuers	68%	27
Large accelerated filers	57%	63
Accelerated filers	36%	14
Non-accelerated filers	12%	21

Sources: 2021 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 includes referred-to auditors and refers only to other accounting firms and not individual accountants at those firms.³¹¹

³¹⁰ Global network firms ("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. Some of the NAFs belong to international networks.

The statistics presented in Figure 2 describe the percentage of issuer audits that use other firms and the maximum number of other firms used in an individual audit, based on 2021 Form AP filings. The results are largely consistent with the 2020 Form AP data presented in the 2021 SRC and indicate that other firms are involved in many audits of issuers.

Overall, other firms are involved in about 26 percent of all issuer audit engagements.³¹² Their use is especially common in audits performed by firms that are members of global networks; about 39 percent of U.S. GNF engagements and about 58 percent of non-U.S. GNF engagements involved the use of other firms. In comparison, only about seven percent of U.S. NAF and 13 percent of non-U.S. NAF audit engagements involved other firms.

When analyzed from the perspective of the domicile of the issuer, other firms are involved in about 23 percent of audit engagements of issuers domiciled in the U.S., and about 41 percent of audit engagements of issuers domiciled outside the U.S. Alternately, when analyzed by issuer size, other firms are involved in about 68 percent of Fortune 500 issuer audits and

³¹¹ Disclosures on Form AP include the name, extent of participation, and headquarters location of an other accounting firm that participated in an audit and contributed 5% or more of the total audit hours. For firms that contributed less than 5% of the total audit hours, the number of firms and their aggregate extent of participation is disclosed. Form AP reporting is required not only in situations when an other accounting firm performed part of an audit under AS 1201 or AS 1205, but also when the personnel of an other accounting firm, but not the firm itself, was involved in the lead auditor's audit. *See* Form AP, Item 3.2 (Note) (providing that an other accounting firm participated in the lead auditor's audit for Form AP reporting purposes if any of its principals or professional employees was subject to supervision under AS 1201). Thus, not all of the audits in the table may have involved, and not all of the firms in the table may have been, other auditors that performed part of the audit under AS 1205 or were themselves supervised under AS 1201.

³¹² The 2021 SRC presented data showing that other firms were involved in about 30 percent of all issuer audit engagements. *See* 2021 SRC at 51. The change from 30 percent in the 2021 SRC to 26 percent in this release appears to be mostly due to the recent increase in special purpose acquisition company audits, which rarely involve the participation of other firms. Between 2018 (the first full year of Form AP data) and 2020 (the year presented in the 2021 SRC), the percentage of audits that use other firms remained relatively stable.

about 57 percent of large accelerated filer audits.³¹³ In contrast, only about 36 percent of accelerated filer audits and about 12 percent of non-accelerated filer audits involved the use of other firms.

Some issuer audits involve many other firms, particularly when the issuer is large. For example, the audit of one Fortune 500 issuer involved 27 other firms and the audit of one large accelerated filer involved 63. By contrast, the maximum number of other firms used on an audit of an accelerated filer and a non-accelerated filer was somewhat lower, at 14 and 21 other firms, respectively. The maximum number of other firms used is highest for issuer audits conducted by GNFs. For example, one non-U.S. GNF audit involved 63 other firms and one U.S. GNF audit used 27. Non-affiliated firms can also use multiple other firms when conducting issuer audits; on one audit a non-U.S. NAF used 17 other firms and one U.S. NAF audit involved 10.

³¹³ For an explanation of accelerated filer criteria, see <https://www.sec.gov/corpfin/secg-accelerated-filer-and-large-accelerated-filer-definitions>.

Figure 3. Audits Involving Multiple Other Auditors (2021)

	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	61%	28%	11%	2%
By audit firm type				
U.S. GNF	66%	32%	11%	1%
Non-U.S. GNF	71%	31%	16%	4%
U.S. NAF	19%	2%	0%	0%
Non-U.S. NAF	34%	5%	5%	0%
By issuer domicile				
U.S. issuers	61%	28%	9%	1%
Non-U.S. issuers	64%	29%	14%	4%

Sources: 2021 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 includes referred-to auditors and refers only to other accounting firms and not individual accountants at those firms.

The statistics shown in Figure 3 describe how often more than one other firm is used when an audit involves such use, based on 2021 Form AP filings. The results are largely consistent with the 2020 Form AP data presented in the 2021 SRC and indicate that when other firms are used, it is common that multiple other firms are used.³¹⁴ For example, among all issuer audits involving the use of other firms, about 61 percent involved two or more other firms, about

³¹⁴ 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.

28 percent involved five or more, about 11 percent involved ten or more, and about two percent involved twenty or more. 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 firms than NAFs do. For example, in issuer audits conducted by U.S. GNFs that involved other firms, about 66 percent involved two or more other firms, about 32 percent involved five or more, about 11 percent involved ten or more, and about one percent involved twenty or more. Similarly, in audit engagements of issuers conducted by non-U.S. GNFs that involved other firms, about 71 percent involved two or more other firms, about 31 percent involved five or more, about 16 percent involved ten or more, and about four percent involved twenty or more. By contrast, in audit engagements of issuers conducted by U.S. NAFs that involved other firms, only about 19 percent involved two or more other firms, and about two percent involved five or more. In audit engagements of issuers conducted by non-U.S. NAFs that involved other firms, about 34 percent involved two or more other firms, and about five percent involved five or more.

Figure 4. Other Auditors' Share of Total Audit Hours (2021)

	Percentage of audits involving other auditors where other auditors performed: ³¹⁵	
	10% or more of total audit hours	30% or more of total audit hours
All issuer audits	52%	19%
By audit firm type		
U.S. GNF	52%	13%
Non-U.S. GNF	58%	34%
U.S. NAF	37%	18%
Non-U.S. NAF	63%	41%
By issuer domicile		
U.S. issuers	48%	12%
Non-U.S. issuers	61%	35%

Sources: 2021 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 includes referred-to auditors and refers only to other accounting firms and not individual accountants at those firms.

The statistics presented in Figure 4 describe the share of audit work performed by other firms, based on 2021 Form AP filings. The other firms' share of total audit hours provides a simple measure of the significance of their work, but may not reflect the level of risk associated with that work. The results are largely consistent with the 2020 Form AP data presented in the 2021 SRC and show that work performed by other firms can, however, account for a significant

³¹⁵ Using a higher threshold of other firms' involvement (50 percent of total audit hours) would further reduce the percentages reported in Figure 4. Specifically, in audits of issuers that involved other firms, other firms performed more than 50 percent of total audit hours in about six percent of all issuer audits, about two percent of U.S. GNF audits, about 16 percent of non-U.S. GNF audits, about four percent of U.S. NAF audits, and about 29 percent of non-U.S. NAF audits.

share of the audit. To illustrate this finding, consider the following data regarding the frequency with which other firms' 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 firms, other firms performed more than 10 percent of total audit hours in about 52 percent of all issuer audits, about 52 percent of U.S. GNF audits, about 58 percent of non-U.S. GNF audits, about 37 percent of U.S. NAF audits, and about 63 percent of non-U.S. NAF audits. When examined by the domicile of the issuer, other firms performed more than 10 percent of the total audit hours in about 48 percent of audits of issuers domiciled in the U.S., and about 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 firms, other firms performed more than 30 percent of the total audit hours in about 19 percent of all issuer audits, about 13 percent of U.S. GNF audits, about 34 percent of non-U.S. GNF audits, about 18 percent of U.S. NAF audits, and about 41 percent of non-U.S. NAF audits. Other firms performed more than 30 percent of the total audit hours in about 12 percent of audits of issuers domiciled in the U.S., and about 35 percent of audits of issuers domiciled outside the U.S.

Auditing Practice Related to the Use of Other Auditors and Referred-to Auditors

PCAOB Staff Analysis of Audit Methodologies

PCAOB staff has reviewed the methodologies of firms related to the use of other auditors and referred-to auditors. Specifically, the staff compared methodologies of GNFs and methodologies commonly used by smaller U.S. firms to current PCAOB standards and the

amendments. The staff performed this analysis to understand the extent to which firms would need to update their methodologies to implement the amendments and new standard.

In general, the staff observed that the methodologies of larger firms already incorporate some of the concepts included in the amendments and new standard. For example, methodologies of larger firms increasingly emphasize the responsibility of the lead auditor for overseeing the work of other auditors using a risk-based approach. Some larger firms have also made changes to their audit methodologies in recent years 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 also 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 U.S. firms' methodologies generally do not require the lead auditor to perform or consider supervisory procedures beyond the requirements of AS 1205.

The staff's analysis of audit methodologies also identified variation in the extent to which larger firms have already incorporated the amendments and new standard in their methodologies. For example, the staff observed that some larger firms' methodologies do not yet incorporate the amendments to supervisory procedures in multi-tiered audits or the amendments to AS 1220 regarding engagement quality reviews. Similarly, many firms may need to revise their approaches to determining whether the firm's participation in an audit is sufficient for it to serve as lead auditor.

Commenters on the 2016 Proposal who addressed audit methodologies regarding the use of other auditors and referred-to auditors generally agreed that the Proposal accurately described existing audit practices. Some of those commenters indicated that many firms, particularly

larger and mid-size firms, have updated their methodologies to comply with the relevant standards of the PCAOB, IAASB, and ASB. Another commenter indicated that firms utilize a range of approaches to group audits to address the varied business structures of their audit clients.

A commenter on the 2021 SRC observed the increased use of technology in auditing, which accelerated in response to the global COVID-19 pandemic. Some stated that, as a result of the use of technology, audit firms increasingly digitize their documentation and are able to communicate more efficiently. Others observed that the increased use of technology has permitted the remote performance of audit work, and that physical location is not as important as it was previously. One commenter noted changes in the management of audits, including the increased use of shared service centers and the existence of more complex group audit structures. Some commenters, however, stated that they had not seen significant changes in auditor practices related to the use of other auditors.

Deficiencies in Audits Involving Other Auditors

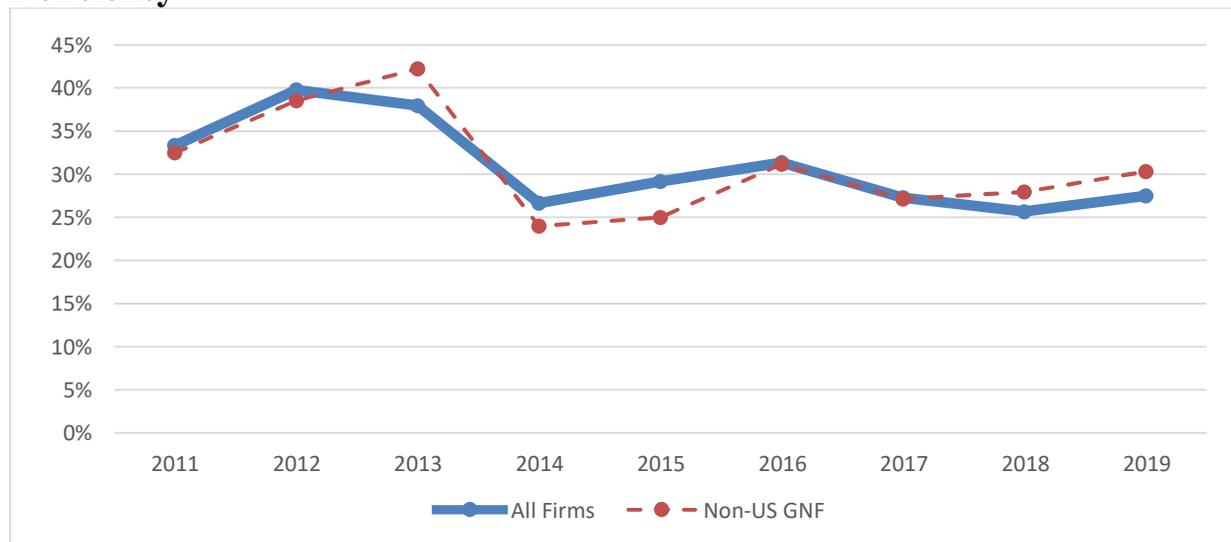
Previous discussion in this release describes observations from recent PCAOB inspections and PCAOB and SEC enforcement cases related to the work of other auditors and lead auditors. This section supplements the discussion by describing data regarding deficiencies in work performed by other auditors (or "referred work engagements").

Over the last decade, PCAOB inspections staff has observed Part I.A deficiencies³¹⁶ in roughly 25 to 45 percent of referred work engagements selected for review. As shown in Figure

³¹⁶ A Part I.A deficiency is identified through inspection and included in a PCAOB inspection report when it is "of such significance that 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*

5, 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.

Figure 5. Percentage of Referred Work Engagements with a Part I.A Deficiency



Academic Research on the Use of Other Auditors

As discussed above, 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.³¹⁷

Procedures: What Does the PCAOB Inspect and How Are Inspections Conducted?, available at <https://pcaobus.org/oversight/inspections/inspection-procedures>.

³¹⁷ See 2016 Proposal at 29-30 and notes 61-64; see also 2021 SRC at 55 and note 147.

If the cost to the auditor of overcoming these challenges (e.g., through additional supervision of other auditors) exceeds the lead auditor's perception of the benefits of doing so (e.g., in terms of reduced risks of litigation, reputational loss, and regulatory sanction, as a result of improving audit quality), then audit quality may suffer.³¹⁸ The impact on audit quality could be especially significant because the lead auditor makes important decisions about how the audit is performed, including whether the lead auditor performs a sufficient portion of the audit to issue the audit report.

Although relatively few empirical studies have explicitly examined the relationship between the use of other auditors and audit quality, several papers have been published recently that shed light on this issue. This 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.³¹⁹

Need

This section discusses the problem that the amendments are intended to address and explains how the amendments are expected to address it. Specifically, an incentive problem may arise from information asymmetries between investors and the lead auditor and between the lead auditor and other auditors, among other factors. The amendments will help address the problem

³¹⁸ See 2016 Proposal at 29 note 61.

³¹⁹ See 2016 Proposal at 29 note 61; see also 2021 SRC at 56 notes 148-149 (citing academic research); see also Elizabeth Carson, Roger Simnett, Ulrike Thürheimer, and Ann Vanstraelen, *Involvement of Component Auditors in Multinational Group Audits: Determinants, Audit Quality, and Audit Fees* (2022) (accepted for publication in *Journal of Accounting Research*; available at <https://doi.org/10.1111/1475-679X.12418>) ("[I]nvolvement of component auditors benefits audit quality as long as the principal auditor conducts a substantial amount of work. Once the involvement of component auditors exceeds a certain level, audit quality decreases.").

by increasing the accountability of the lead auditor and requiring a more uniform, risk-based approach to the lead auditor's planning and supervision of the work of other auditors. The amendments aim to clarify and strengthen the lead auditor's planning and supervisory requirements to provide lead auditors with better direction and a stronger regulatory incentive to more consistently produce high quality audits when using other auditors. The amendments will 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.

Problem to Be Addressed

As discussed in the 2016 Proposal, incentive problems may arise from information asymmetry between investors and the lead auditor.³²⁰ Specifically, in audits involving other auditors, a market failure³²¹ may be caused, at least in part, by an information asymmetry between investors and the lead auditor regarding 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. The uncertainty may reduce public confidence in financial information, decrease the efficiency of capital allocation decisions, and increase the cost of capital.³²²

³²⁰ See 2016 Proposal at 30-33 and notes 66-73.

³²¹ The term "market failure" refers to a situation in which markets fail to function efficiently. See 2016 Proposal at 31 note 67.

³²² See 2016 Proposal at 37 note 78.

Because of this information asymmetry and other factors such as cost considerations, the lead auditor may not be adequately motivated 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, leading to a moral hazard problem.³²³

Further, as discussed in the 2021 SRC, incentive problems may also arise from information asymmetry between lead auditors and other auditors.³²⁴ 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.³²⁵ Other auditors also may not be sufficiently incentivized to perform sufficient and appropriate audit procedures. A commenter on the 2021 SRC agreed that information asymmetry may exist between auditors.

How the Amendments Will Address the Need

The amendments are expected to increase the accountability of the lead auditor and require a more uniform, risk-based approach to the lead auditor's oversight of other auditors. Specifically, the amendments rescind AS 1205 and amend AS 2101 and AS 1201 to apply in all situations in which the lead auditor involves other auditors. The amendments include additional risk-based requirements to provide the lead auditor with more specificity and clarity about the lead auditor's supervisory responsibilities.

³²³ The term "moral hazard" refers to a situation in which an agent could take actions (such as not putting forth sufficient effort) that are difficult for the principal to monitor and would benefit the agent at the expense of the principal. *See* 2016 Proposal at 31 note 69; *Amendments to Auditing Standards for Auditor's Use of the Work of Specialists*, PCAOB Release No. 2018-006 (Dec. 20, 2018), at 40-42.

³²⁴ *See* 2021 SRC at 61.

³²⁵ *See* 2016 Proposal at 19-21.

Strengthening the performance requirements for lead auditors can augment the lead auditor's incentive to monitor the performance of other auditors through adequate supervision of other auditors' work. By addressing more clearly the responsibilities of the lead auditor (e.g., for planning the audit and supervising other auditors), the 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. Investors should form expectations of audit quality under the more standardized and improved supervisory framework, and thus should have greater certainty about the lead auditor's approach to supervision and the quality of the audit.³²⁶ 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.³²⁷

Examples of amendments that are expected to strengthen and clarify the performance requirements for lead auditors and augment their incentive to monitor the performance of other auditors include the following:

- In audits involving other auditors, the amendments to AS 2101 and AS 1220 will 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, and the engagement quality reviewer's evaluation of that assessment. In addition, in audits that involve work performed by other auditors regarding locations

³²⁶ See 2016 Proposal at 35 note 75 (citing academic research).

³²⁷ See 2021 SRC at 61 note 175.

or business units, the lead auditor's involvement (through planning and performing audit procedures and supervising other auditors) will be required to be commensurate with the risks of material misstatement associated with those locations or business units. The amendments also describe the actions that the lead auditor should take with respect to each other auditor to determine compliance with independence and ethics requirements. Further, the amendments have specific requirements regarding the lead auditor's responsibilities with respect to the other auditors' knowledge, skill, and ability.

- Currently, lead auditors can apply two different approaches: supervising the other auditors' work under AS 1201 or using the work and reports of other auditors under AS 1205. Under the amendments, AS 1205 will be rescinded, and lead auditors will be required to supervise other auditors under the amended AS 1201 when they assume responsibility for the other auditors' work.

The amendments to AS 1201 provide additional direction to the lead auditor on how to apply the principles-based provisions of the standard to the supervision of other auditors. For example, the amendments require the lead auditor to: (i) inform other auditors of the scope of their work and, with respect to such work requested, the identified risks of material misstatement, tolerable misstatement, and clearly trivial amounts (if determined); (ii) obtain and review the other auditor's written description of procedures to be performed, and discuss with, and communicate in writing to, the other auditor any needed changes to the planned procedures; (iii) obtain and review a written affirmation from the other auditor as to whether the other auditor has performed work in accordance with the lead auditor's instructions, and, if it has not, a

description of the nature of, and an explanation of the reasons for, the instances where work was not performed in accordance with the instructions, including (if applicable) a description of the alternative work performed; (iv) direct other auditors to provide specified documentation regarding work performed; and (v) determine whether the other auditor performed the work as instructed and whether additional audit evidence needs to be obtained.³²⁸

Economic Impacts

This section discusses the expected benefits and costs of the amendments and potential unintended consequences. Overall, the magnitude of the benefits and costs is likely to be affected by the extent to which other auditors are involved in audits, including the number of other auditors used and the amount of time spent by other auditors. Benefits and costs are also likely to be affected by the nature of the work and the risks involved in the work performed by other auditors, because more complex work and work in areas of greater risk will likely require greater supervisory efforts by the lead auditor. In addition, benefits and costs are likely to be affected by the degree to which accounting firms have already adopted audit practices that are similar to those the amendments will require. Overall, the Board expects that the benefits of the amendments will justify any costs and unintended negative effects.

Benefits

As discussed above, the amendments are expected to benefit investors and the public by mitigating information asymmetries between investors and the lead auditor and between the lead

³²⁸ The amendments for the planning and supervision of other auditors also include provisions, in AS 1201 and AS 2101, that are designed to make the standard scalable for multi-tiered audits in which the lead auditor may seek assistance from a first other auditor in supervising second other auditors.

auditor and other auditors. The new requirements should strengthen the supervision of other auditors, which in turn should improve audit quality and increase the likelihood that auditors detect material misstatements in the financial statements and material weaknesses in internal controls over financial reporting. Improving the quality of audits and financial reporting can reduce investors' uncertainty about the information being provided in company financial statements, foster increased public confidence in the financial markets, and enhance capital formation. In particular, improving the quality of the information available to financial markets can increase the efficiency of capital allocation decisions and decrease the cost of capital.³²⁹

Specifically, the amendments address audit deficiencies of other auditors that continue to be observed in practice (see Figure 5 above) and provide more transparency to investors about how lead auditors supervise other auditors by increasing the accountability of the lead auditor and introducing a more uniform, risk-based approach to the lead auditor's supervision of other auditors. The amendments require the lead auditor to determine the sufficiency of its participation in the audit based on quantitative and qualitative factors and be better informed about the qualifications and performance of the other auditor. The amendments also increase the requirements for the lead auditor to monitor and review (i.e., supervise) the work of other auditors.

Investors also may benefit from the amendments indirectly. For example, under existing standards, the auditor is required to communicate to the audit committee its overall audit strategy, significant risks, and results of the audit, including work performed by other auditors, among other things.³³⁰ Because of the lead auditor's enhanced involvement in the work of other

³²⁹ See 2016 Proposal at 37 note 78.

³³⁰ See paragraphs .09–.24 of AS 1301, Communications with Audit Committees.

auditors, the quality of communications with audit committees could also be enhanced, specifically as it relates to risks of material misstatements in the financial statements related to the component(s) of the company audited by the other auditor(s). Such enhanced discussions with the audit committee could improve the audit committee's oversight of the audit by highlighting areas where audit committees and companies should increase attention to ensure the quality of their financial statements, including related disclosures. This increased attention by audit committees and companies could result in higher quality financial reporting, which benefits investors.

The Board expects that the amendments will lead to improved supervision of other auditors' work and an increase in audit quality. Auditors also may benefit from the amendments due to the reduced risk of failure to detect material misstatements. As a result, associated costs such as the risk of litigation, regulatory sanction, or reputational loss faced by auditors could decrease.

Some commenters provided information responding to the discussion of potential benefits to investors and other financial statement users. One commenter said that many of the changes contemplated in the 2016 Proposal would improve the quality of audits involving other auditors and benefit investors. Another commenter stated that the proposed changes should decrease the overall likelihood of misstatement by enhancing the verification process of information relied upon by other auditors, and therefore should serve as added safeguards for investors and the general public through their ability to rely on the financial statement data and related disclosures. Another commenter said that the proposed amendments would provide more transparency about audits involving other auditors and would therefore benefit investors and the public. Similarly, in response to the 2021 SRC, commenters agreed that the amendments would

enhance audit quality and protect the interests of investors. These comments are consistent with the benefits identified in this section.

Costs

The Board recognizes that imposing new requirements may result in additional costs to auditors and the companies they audit.

Auditors may incur certain fixed costs (costs that are generally independent of the number of audits performed) related to implementing the amendments. These include costs to update audit methodologies and tools, and to prepare training materials and conduct training. Large firms are likely to update methodologies using internal resources, whereas small firms are more likely to purchase updated methodologies from external vendors.³³¹ The costs to update methodologies likely depend on the extent to which the new requirements have already been incorporated in the firms' current methodologies. For firms that have implemented supervisory procedures like those required by the amendments, the costs of updating methodologies may be lower than for firms that currently do not have such procedures. Larger accounting firms, which often perform audits involving other auditors, will likely take advantage of economies of scale by distributing fixed costs over a larger number of audit engagements. Smaller accounting firms, which less often perform audits that involve other auditors, will likely distribute their fixed costs over fewer audit engagements.

In addition, auditors may incur certain engagement-level variable costs related to implementing the amendments. For example, to implement the additional requirements, both lead auditors and other auditors may:

³³¹ See 2016 Proposal at 38.

- Increase the number of engagement team members and engagement quality reviewer assistants; or
- Increase the amount of time incurred by the existing team members and engagement quality reviewers and their assistants.³³²

The magnitude of the variable costs likely depends on several factors. For firms that have required greater lead auditor involvement and already have applied some of the new requirements in practice, the variable costs may be lower than for firms that currently require less lead auditor involvement. The variable costs are also likely to be affected by the nature of the engagement, including the extent of involvement of other auditors (e.g., the number of other auditors used and the amount of time spent by other auditors), and the level of risk associated with the audit work performed by other auditors. Finally, the total variable costs are related to the number of audits using other auditors.

Since the total fixed and variable costs of the amendments likely depend on the interaction of all the factors discussed above, it is not clear whether these costs, as a percentage of total audit costs, will be greater for larger or for smaller accounting firms.

For audits in which the lead auditor divides responsibility for the audit with another accounting firm, the anticipated impact of the amendments on the lead auditor's costs is not likely to be significant. Currently, about 40 audits per year involve divided responsibility, and the amendments to PCAOB standards that apply to those scenarios are not as significant as other amendments.

³³² The 2016 Proposal also mentioned the potential additional costs incurred by traveling to a company's locations or business units at which audit procedures are to be performed. *See* 2016 Proposal at 38. As remote work and virtual meetings became more common in recent years, these costs may be less significant.

In addition to auditors, companies being audited may also incur costs related to the amendments, both directly and indirectly. Companies could incur direct costs from engaging with or otherwise supporting the auditor performing the audit. For example, some companies could face costs of producing documents and responding to additional auditor requests for audit evidence, due to more rigorous evaluation of audit evidence by lead and other auditors. To the extent that auditors incur higher costs to implement the amendments and are able to pass on at least part of the increased costs through an increase in audit fees, companies could incur an indirect cost.³³³

In response to the 2016 Proposal, one commenter agreed that the incremental cost due to the 2016 Proposal is likely to be limited because some accounting firms already had implemented many aspects of the 2016 Proposal in their methodology and/or in practice, and because of the risk-based approach taken in the 2016 Proposal. Another commenter stated that audit firms not already complying with the requirements would experience higher costs, but most firms already performed audits under GAAS standards, and for them the increased costs would not be prohibitive. In response to the 2021 SRC, two commenters described potential increased costs when the lead auditor and other auditor are part of the same network. The commenters suggested that the potential increased costs would be caused by the inability to sufficiently leverage common systems of quality control, resulting in unnecessary effort to understand the other auditor's audit procedures. As discussed in the 2017 and 2021 SRCs, however, affiliation through a network does not automatically provide the lead auditor with an understanding of the other affiliates' processes and experience.³³⁴ One commenter recommended the PCAOB

³³³ See 2016 Proposal at 40 note 80.

³³⁴ See 2017 SRC at 14; 2021 SRC at 24.

consider the difficulties encountered and resources used by firms in complying with PCAOB standards, AICPA AU-Cs, and IAASB ISAs. The Board's considerations are discussed below.

Potential Unintended Consequences

In addition to the benefits and costs discussed above, the amendments could have unintended economic impacts. The 2016 Proposal described a number of potential unintended consequences, resulting in public comments on those topics and others. This section discusses the potential unintended consequences as well as the Board's consideration of such consequences in adopting the amendments.³³⁵ The discussion also addresses, where applicable, factors that mitigate the potential consequences, including revisions to the proposed amendments reflected in the amendments the Board is adopting and the existence of other countervailing factors.

Accountability of Other Auditors

Unlike AS 1205, AS 1201 does not contain a statement that "the other auditor remains responsible for the performance of his own work and for his own report." Thus, it is possible that the other auditor could feel less accountable given that the amendments focus the responsibility for providing direction and supervision of the other auditor on the lead auditor. If this occurred, audit quality could decrease.

Commenters expressed differing views on the 2016 Proposal's potential impact on other auditors' accountability. Several commenters stated that the proposed amendments would not

³³⁵ In addition to the potential unintended consequences discussed in this section, potential results of certain other aspects of the proposed amendments were described by some commenters as "unintended." These and other comments are discussed elsewhere in this release in conjunction with the following aspects of the final amendments: the sufficiency-of-participation determination for serving as the lead auditor; other auditors' compliance with independence and ethics requirements; other auditors' knowledge, skill, and ability; informing other auditors of their responsibilities; directing other auditors to perform certain supervisory procedures in a multi-tiered audit; and dividing responsibility for the audit.

diminish other auditors' overall accountability. Other commenters stated that if the amendments are applied correctly, the lead auditor's supervision should hold the other auditors to a higher level of overall accountability and improve the overall quality of other auditors' work.

Other commenters expressed concern that the 2016 Proposal did not include the statement in AS 1205.03 about other auditors' responsibility. Omitting this provision, in their view, may be interpreted as a reduction in the responsibility and accountability of other auditors, which could have adverse effects on audit quality. Some commenters recommended retaining the existing provision or including an analogous requirement to address the other auditors' responsibility.

To mitigate this potential negative consequence, AS 1015 is being amended to emphasize that the other auditors are responsible for performing their work with due professional care.³³⁶ This amendment was proposed in the 2017 SRC and supported by commenters. Notably, under the amended standards, the other auditor remains responsible for performing its assigned work with due professional care and otherwise in conformance with PCAOB standards. This responsibility is reflected in the auditor documentation the other auditor must prepare regarding the work performed, including written affirmation to the lead auditor regarding whether the other auditor performed its work in accordance with the lead auditor's instructions, including applicable PCAOB standards. In addition, the other auditor's work is subject to greater oversight by the lead auditor under the amended standards, which will reduce the other auditor's opportunities for performing insufficient work without detection. Finally, the other auditor's work continues to be subject to PCAOB oversight activities due to its participation in the audit.

³³⁶ The PCAOB's underlying standards governing the work of other auditors and referred-to auditors will similarly continue to apply to their work.

Time of Lead Auditor

Because lead auditor personnel will be required to perform additional supervisory responsibilities, such team members might have less time to perform other work on the same engagement. This could potentially reduce the likelihood that the auditor detects material misstatements in the portion of the financial statements for which the lead auditor performs procedures and could potentially lead to inefficient allocation of audit resources. Several commenters on the 2016 Proposal agreed that this potential unintended consequence could arise, adding that the increased planning and supervisory effort required of the lead auditor could also leave less time for the lead auditor to consider important issues.

The Board's inclusion of risk-based supervision requirements in the amended standards is intended to mitigate the possibility that the lead auditor will neglect work it intends to perform because of the attention it devotes to other auditors. In particular, the additional supervisory procedures required for the lead auditor's supervision of work performed by other auditors are intended to provide the lead auditor with a basis for concluding whether the financial statements are free of material misstatement. Thus, under the amended standards, the lead auditor should be focusing its efforts on audit areas with the greatest risk of material misstatement to the financial statements, whether those areas are audited by the lead auditor directly or by an other auditor under the lead auditor's supervision. Further, as lead auditor personnel gain experience and become more efficient in applying the new requirements related to other auditors, the likelihood that the lead auditor misallocates its time and resources should decrease.

Involvement by Other Auditors

In response to (i) the potential costs or any practical difficulties of supervising other auditors under the amended standards or (ii) the sufficiency-of-participation requirements, the

lead auditor, in some circumstances, may decrease the share of work performed by other auditors and increase the share of its own work. While this may be an efficient and effective response in certain circumstances, limiting other auditors' involvement in the engagement may negatively affect audit quality to the extent the other auditors possess knowledge of important country-specific information. Two commenters on the 2016 Proposal agreed that this unintended consequence may arise.

This potential outcome, however, would be contrary to the following requirements in PCAOB standards:

- "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."³³⁷
- "The knowledge, skill, and ability of engagement team members with significant engagement responsibilities should be commensurate with the assessed risks of material misstatement."³³⁸
- Firms are required to have policies and procedures in place that provide reasonable assurance that the firm will undertake "only those engagements that the firm can reasonably expect to be completed with professional competence."³³⁹

In addition, legal restrictions in some countries that prohibit a foreign auditor from providing professional services in the country could limit a foreign lead auditor's ability to take

³³⁷ AS 1015.06.

³³⁸ Paragraph .05a of AS 2301, The Auditor's Responses to the Risks of Material Misstatement.

³³⁹ Paragraph .15a of QC 20, System of Quality Control for a CPA Firm's Accounting and Auditing Practice.

on more work and assign less work to other auditors in the country. The Board anticipates that lead auditors will find the appropriate balance between the lead auditor and other auditor involvement in the audit as accounting firms gain experience in implementing the new requirements and seek to maximize the effectiveness and efficiency of audit engagements.

Occurrence of Divided Responsibility

Some auditors who currently use an other auditor's work under AS 1205 may view compliance with the supervision requirements of AS 1201 (as amended) as too costly and decide instead to divide responsibility for the audit. Several commenters on the 2016 Proposal agreed that this unintended consequence may arise, although some of them added that the likelihood was low. There are limited research findings available regarding the division of responsibility,³⁴⁰ and it is not clear how an increase in audits with divided responsibility would affect audit quality. To provide transparency about such situations, the amendments require that, in a divided-responsibility scenario, the lead auditor disclose in its audit report: (i) the part of the audit that is performed by another accounting firm; (ii) the magnitude of the portion of the company's financial statements audited by the referred-to auditor; (iii) the referred-to auditor's name; and (iv) which auditor (lead or referred-to) has audited the conversion adjustments when

³⁴⁰ See 2016 Proposal at 42 and note 84; see also Juan Mao, Michael Ettredge, and Mary Stone, *Group Audits: Are Audit Quality and Price Associated with the Lead Auditor's Decision to Accept Responsibility?*, 39(2) *Journal of Accounting and Public Policy* 1 (2020) (examining whether a lead auditor's disclosure of its choice to accept or decline (i.e., divide) responsibility for the work of another firm is associated with differences in audit fees or audit quality, and finding that "[l]ead auditors accepting responsibility charge higher audit fees but provide audits of no higher quality, and possibly of even lower quality").

the financial statements of the company and its business unit are prepared using different financial reporting frameworks.³⁴¹

Impact on Smaller Firms

The amendments will likely have an economic impact on audits performed by smaller firms that use other auditors. This is because smaller firms (i) are less likely to perform today the procedures described in the amendments and (ii) generally lack the economies of scale to distribute the additional fixed costs over many audits.³⁴² The 2016 Proposal also noted that additional supervisory requirements could decrease competition in the audit market for audits involving other auditors if smaller firms are less able to compete with larger firms.³⁴³

Several commenters on the 2016 Proposal agreed that this unintended consequence may arise. One commenter stated that, for smaller firms, complying with the proposed supervisory responsibilities may increase costs to such an extent that some smaller firms may exit the market for audits involving other auditors. Another commenter said that it would be harder for smaller firms than for larger firms to meet the proposed threshold for serving as lead auditor.

However, as discussed above, staff analysis using Form AP data shows that smaller firms already perform relatively fewer audits that involve other accounting firms than larger firms, and when they do, they use fewer other accounting firms.³⁴⁴ Thus, any impact on competition in the overall audit market is likely to be relatively small.

³⁴¹ See paragraphs AS 1206.06d and .08. Rule 2-05 of Regulation S-X, 17 CFR 210.2-05, includes requirements regarding filing the referred-to auditor's report with the SEC.

³⁴² See discussion above.

³⁴³ See 2016 Proposal at 43.

³⁴⁴ See Figures 2 and 3 above.

The Board's risk-based and scalable approach to designing the amendments is also intended to maintain a level playing field for all auditors choosing to involve other auditors in their audit, regardless of their size. Scalability is a characteristic of policy that typically refers to circumstances where requirements are general enough (e.g., principles-based) to be adapted effectively and efficiently under different facts and circumstances. Risk-based requirements are usually scalable because the necessary level of audit effort varies depending on the level of complexity and risk. Thus, risk-based requirements are likely to be relatively efficient (or at least not inefficient), because the auditor's incentives and discretion are likely to result in costs being incurred primarily in circumstances involving a corresponding, and potentially larger, risk-mitigation benefit to investors.³⁴⁵ Under the amendments, the lead auditor would be required to determine the extent of supervision of other auditors based on, among other things, the nature of work, and risk of material misstatement.

Benefit From Additional Requirements

It is possible that some audits (e.g., those previously conducted under AS 1205) will not benefit from the new requirements. This could occur, for example, on very simple low-risk audits that involve highly qualified other auditors. In such circumstances, the lead auditor could incur incremental costs to comply with the additional planning and supervisory requirements in the amended standards without yielding a corresponding benefit to audit quality.

This inefficient outcome is mitigated by the risk-based and scalable aspects of the amended standards, which rely on the lead auditor to make judgments about the nature and extent of supervision of other auditors based on risks. The Board anticipates that as lead auditors gain experience implementing the new requirements, they will make appropriate judgments that

³⁴⁵ See 2017 SRC at 40.

are efficient and effective at achieving the desired level of audit quality. The Board received no comments on this potential unintended consequence described in the 2016 Proposal.

Alternatives Considered

The development of this rulemaking involved the consideration of a number of alternative approaches to address the problems described above. This section explains (i) why standard setting is preferable to other policy-making approaches, such as providing interpretive guidance or enhancing inspection or enforcement efforts; (ii) other standard-setting approaches that were considered; and (iii) key policy choices made by the Board in determining the details of the standard-setting approach in this rulemaking.

Why Standard Setting Is Preferable to Other Policy-Making Approaches

The Board's policy tools include alternatives to standard setting, such as issuing additional interpretive guidance or an increased focus on inspections or enforcement of existing standards. The Board considered whether providing guidance or increasing inspection or enforcement efforts would be effective corrective mechanisms to address concerns with the supervision of other auditors and the sources of information asymmetry discussed above. The Board concluded that interpretive guidance, inspections, or enforcement actions alone would be less effective in achieving the Board's objectives than in combination with amending the auditing standards. Interpretive guidance inherently provides additional information about existing standards. Inspections and enforcement actions take place after insufficient audit performance (and potential investor harm) has occurred. Devoting additional resources to guidance, inspections, and enforcement activities without improving the relevant performance requirements for auditors would, at best, focus auditors' performance on existing standards and would not gain the benefits associated with improving the standards. Two commenters expressed support for an

approach that includes standard setting.³⁴⁶ The Board's approach reflects its conclusion that standard setting is needed to fully achieve the benefits resulting from improvement in audits involving multiple auditors.

Other Standard-Setting Alternatives Considered

The Board also considered certain standard-setting approaches, including: (i) retaining the existing framework but requiring the lead auditor to disclose which standard (AS 1201 or AS 1205) governs the relationship between the lead auditor and other auditors; (ii) amending AS 1205 or extending the approach in that standard to cover all arrangements involving other auditors and referred-to auditors; (iii) developing a new standard, in addition to the Board's risk assessment standards, that would address all arrangements with other auditors and referred-to auditors; or (iv) amending existing standards to address the oversight of multi-location audit engagements generally (including multi-location engagements performed by a single firm), in addition to amending the standards to address the auditor's use of other auditors and referred-to auditors.

Disclosing Which Standard Applies Under Existing Framework

The Board considered but is not adopting a requirement that the lead auditor disclose, in the audit report or elsewhere, whether the lead auditor applied AS 1205 or AS 1201 in its oversight of the other auditor. Such a disclosure approach would not achieve the benefits of applying AS 1201 (as amended) to all audits that involve other auditors, and inconsistencies between firms in their approaches to the oversight of other auditors would remain.

³⁴⁶ These commenters also suggested improving the practicability of proposed requirements by allowing the lead auditor to seek assistance from other auditors in supervising the audit to a greater extent than the Board proposed. In response to these and other comments, the Board made a number of changes in the 2021 SRC to address the practicability concern, including in connection with multi-tiered audits.

From an economic perspective, it is more efficient and effective to address the reasons for change described above by amending existing auditing standards on supervision than by disclosing which standard applies. The amendments directly address the lead auditor's incentives, whereas disclosing which one of the standards (before the amendments) applies would do so indirectly at best. For disclosure to sufficiently change the lead auditor's incentives, investors would need to apply significant market pressure on auditors to improve their supervisory procedures beyond requirements in PCAOB standards (before the amendments). This approach seems unlikely given the wide dispersion of share ownership among investors and the costs of engaging in collective action.

Amending AS 1205

The Board considered, but is not adopting, two alternative approaches that would amend rather than rescind AS 1205. The first approach would have amended AS 1205 to strengthen its oversight requirements but otherwise retained the existing two-standard framework in which an engagement involving other auditors could be governed by either AS 1205 or AS 1201, depending on the circumstances of the engagement. The second approach would have amended AS 1205 to extend its application to all arrangements involving other auditors and referred-to auditors such that AS 1201 would no longer apply.

The Board determined that the risk-based supervision approach in AS 1201 promotes a more appropriate involvement by the lead auditor than the approach in AS 1205. The supervisory approach in AS 1201 requires that the level of supervision be commensurate with the associated risks, and that would apply to the supervision of the other auditors' work. From an economic perspective, the risk-based approach, which is now a well-established and understood auditing practice, requires the lead auditor to take into account the facts and circumstances of an

audit engagement to inform a variety of resource allocation decisions, including the nature, timing, and extent of its supervision of other auditors. This approach enables the lead auditor to better align its supervisory effort with the level of risk, focusing more attention on the riskiest areas of the audit and thus provide more risk mitigation benefit to investors. Similarly, the other auditors' communication of important and relevant information to the lead auditor allows the lead auditor to make better-informed decisions regarding the work of the other auditor.

In contrast, AS 1205 employs an approach that allows the lead auditor to use the work of other auditors based on the performance of certain limited procedures that are not explicitly required to be tailored for the associated risks. Thus, the approach of AS 1205 would not address the problems described in this release as effectively as the supervisory approach of AS 1201.

*Developing a New Standard for All Arrangements with Other Auditors
and Referred-to Auditors*

The Board also considered developing a new, separate standard to govern all arrangements with other auditors and referred-to auditors. In that regard, some commenters suggested the PCAOB align a new standard with the relevant standards of other standard setters such as the IAASB. Although the IAASB has a separate standard for group audits, ISA 600, the Board believes that adopting a separate standard in its auditing standards is not necessary for most audits in which the lead auditor uses the work of other auditors. (The Board is, however, adopting a separate standard, AS 1206, to govern divided-responsibility audits, which are relatively uncommon.) Specifically, the existing standard on supervision, AS 1201, which is integrated with the Board's other risk assessment standards, already includes principles-based requirements that apply to audits involving other auditors in situations not covered by AS 1205.

Extending the requirements of AS 1201 to all situations involving other auditors and adding to AS 1201 more specific requirements for supervising the other auditor's work is a more efficient way to incorporate these requirements into the existing framework of PCAOB auditing standards. In addition, as discussed above, some commenters supported the Board's objective of establishing requirements for using other auditors' work that are risk-based and more closely aligned with the Board's risk assessment standards than existing standards. Accordingly, this rulemaking takes an integrated approach that involves enhancing the existing standard through targeted amendments that impose certain requirements on the lead auditor, rather than creating an entirely new standard.

Amending to Address Oversight of Multi-location Engagements

The Board considered, but is not adopting, amendments to existing standards that would apply to oversight of multi-location audit engagements generally (including multi-location engagements performed by a single firm), in addition to amendments that apply to the auditor's use of other auditors and referred-to auditors. The Board is not adopting such amendments because existing PCAOB auditing standards already specifically address multi-location engagements.³⁴⁷ Additional requirements for these audits, along with requirements for supervising other auditors, could create unnecessary complexity and redundancy with existing requirements. Finally, the Board through its oversight has seen less cause for concern regarding single-firm multi-location engagements compared to audits involving other auditors.

³⁴⁷ Requirements for multi-location engagements are specifically addressed in risk assessment standards adopted by the Board in 2010 and in certain other standards. *See, e.g., AS 2101; AS 2105, Consideration of Materiality in Planning and Performing an Audit; AS 2110, Identifying and Assessing Risks of Material Misstatement; AS 2301. See also AS 2401, Consideration of Fraud in a Financial Statement Audit; Paragraphs A60–A67 of AS 1215, Appendix A: Background and Basis for Conclusions; AS 6115, Reporting on Whether a Previously Reported Material Weakness Continues to Exist.*

Key Policy Choices

Given a preference for amending AS 1201, the Board considered different approaches to addressing key policy issues.

Sufficiency of the Lead Auditor's Participation

To increase the likelihood that a lead auditor is meaningfully involved in the audit, the amendments require that the lead auditor determine the sufficiency of its participation in each audit that involves other auditors or referred-to auditors.³⁴⁸ Sufficient participation by the lead auditor is required so that the work of all audit participants is properly planned and supervised, the results of the work are properly evaluated, and the lead auditor is in a position to conclude that the financial statements are presented fairly in all material respects. In evaluating the alternative approaches, the Board weighed the practical implications of specific criteria or conditions on the efficiency and effectiveness of the audit. The Board also evaluated, among other things, relevant information from its oversight activities and views from Standing Advisory Group (SAG) members.³⁴⁹

The requirement for determining sufficiency of participation which the Board is adopting is based on the following criteria: (i) the importance of the locations or business units for which the engagement partner's firm performs audit procedures in relation to the financial statements as a whole, considering quantitative and qualitative factors; (ii) the risks of material misstatement associated with the portion of the financial statements audited by the engagement partner's firm

³⁴⁸ See paragraphs .06A–.06C of AS 2101.

³⁴⁹ See SAG Meeting Archive (May 18, 2016; Dec. 1, 2016; May 24, 2017; Nov. 30, 2017), available at <https://pcaobus.org/about/advisory-groups/archive-advisory/standing-advisory-group/sagmeetingarchive>. Transcripts of the relevant portions of SAG meetings related to this project are available in the docket for this rulemaking on the PCAOB's website (<https://pcaobus.org/Rulemaking/Pages/Docket042.aspx>).

in comparison with the other auditors' or referred-to auditors' portions; and (iii) the extent of the engagement partner's firm's supervision of the other auditors' work. The second consideration is aligned with the principle of determining the scope of work in a multi-location audit, as both take into account the risk associated with the respective locations or business units. The first and third considerations cover specific situations that may arise in audits involving other auditors or referred-to auditors, where applicable; these considerations address concerns about the practicability of the proposed requirements that were expressed by some commenters on the 2016 Proposal, the 2017 SRC, and the 2021 SRC.

The Board considered prescribing additional considerations for determining sufficiency of participation based on the location of the company's principal assets, principal operations, and corporate offices. Such additional considerations were not adopted because the considerations in the final amendments already encompass them to the extent they reflect the importance of the location or pose risks of material misstatement to be addressed in the audit. Moreover, as further discussed in this release, the Board is concerned that adding more considerations could increase the risk that the firm issuing the auditor's report would not meaningfully participate in the audit, and thus would be the "lead auditor" in name only.

Lead Auditor's Supervisory Requirements

When other auditors are involved in an audit, the Board considered whether the lead auditor (which includes the engagement partner and other supervisory personnel of the firm issuing the audit report) should be specifically required to perform certain supervisory procedures, and what the scope of any such procedures should be. PCAOB standards allow the engagement partner to seek assistance from appropriate engagement team members in fulfilling his or her supervisory responsibilities, but the standards for supervision (without the

amendments) do not specify which supervisory procedures must be performed by the lead auditor.

In many audits, engagement partners seek assistance in fulfilling their supervisory responsibilities from engagement team members at other accounting firms that participate in the audit. By increasing the lead auditor's monitoring responsibilities, the supervisory procedures for the lead auditor that are described in the amendments should 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. Thus, these amendments aim to change auditor behavior by strengthening the incentives of the lead auditor and therefore addressing the information and incentive problems discussed above.

The Board considered, but is not adopting, a requirement that the lead auditor obtain an understanding of the qualifications of all engagement team members outside the lead auditor's firm. Instead, the amended standards require that the lead auditor obtain an understanding of the knowledge, skill, and ability of the other auditor's engagement team members who assist the engagement partner with planning or supervision.³⁵⁰ Further, in response to comments on the proposed requirements, the amendments provide that in audits involving multiple tiers of other auditors, the lead auditor may seek assistance from the first other auditor in performing this procedure with respect to the second other auditor.³⁵¹ The requirement the Board is adopting is designed to result in a more effective allocation of audit resources by focusing the lead auditor's

³⁵⁰ See AS 1015.06 and AS 2101.06Ha, according to which "[e]ngagement team members should be assigned to tasks and supervised commensurate with their level of knowledge, skill, and ability" This provision is discussed in more detail above in this release.

³⁵¹ This provision is discussed in more detail above in relation to "multi-tiered audits" in this release.

efforts on the engagement team members outside the firm with whom the lead auditor primarily communicates and who are responsible for planning or supervising the work performed by other engagement team members.

The Board also considered, but is not adopting, a requirement that the lead auditor determine the nature, timing, and extent of audit procedures to be performed by the other auditors. Instead, the amended standards require that the lead auditor determine the scope of the work of other auditors and review the other auditors' written description of audit procedures to be performed pursuant to the scope of work requested. The amended standards also require that the lead auditor determine whether there are any changes necessary to the procedures and discuss the changes with, and communicate them in writing to, other auditors. This approach is more effective because the lead auditor generally has better visibility of the entire audit, and the other auditors generally have more detailed information than the lead auditor about audit areas in which they are involved.

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 (i.e., EGCs), as defined in Section 3(a)(80) of the Securities Exchange Act of 1934, 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."³⁵²

³⁵² See Pub. L. No. 112-106 (Apr. 5, 2012). See Section 103(a)(3)(C) of Sarbanes-Oxley, 15 U.S.C. 7213(a)(3)(C), as added by Section 104 of the JOBS Act also provides that any rules of the Board requiring (1) mandatory audit firm rotation or (2) a supplement to the auditor's report in which the auditor would be required to provide additional information about the audit

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.

The proposing releases sought comment, including any available empirical data, on how the proposed amendments to the auditing standards would affect EGCs, and whether they would protect investors and promote efficiency, competition, and capital formation.³⁵³ Commenters generally supported applying the proposed requirements to audits of EGCs. One noted the increased risks associated with EGCs and that applying the amendments to EGC audits could help to address those risks. Others emphasized that consistent requirements should apply for similar situations encountered in any audit of a company, whether that company is an EGC or not. One commenter on the 2021 SRC agreed with the Board's statements that the benefits to audit quality through improved planning and supervision may be especially significant for EGC audits, and that the amendments could contribute to an increase in the credibility of EGCs' financial reporting.

To inform consideration of the application of auditing standards to audits of EGCs, PCAOB staff prepares a white paper annually that provides general information about characteristics of EGCs.³⁵⁴ As of the November 15, 2020 measurement date, PCAOB staff

and the financial statements of the issuer (auditor discussion and analysis) shall not apply to an audit of an EGC. The amendments do not fall within either of these two categories.

³⁵³ See 2016 Proposal at 51; 2017 SRC at 43; 2021 SRC at 66.

³⁵⁴ For the most recent EGC report, see *Characteristics of Emerging Growth Companies and Their Audit Firms at November 15, 2020* (Jan. 24, 2022), available at https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/economicandriskanalysis/projectsother/documents/white-paper-on-characteristics-of-emerging-growth-companies-at-november-15-2020.pdf?sfvrsn=ee0e6910_3.

identified 1,940 companies that self-identified with the SEC as EGCs and filed audited financial statements in the 18 months preceding the measurement date.³⁵⁵

Analysis of Form AP filings in 2021 indicates that audits of EGCs are less likely to involve other accounting firms (i.e., other auditors and referred-to auditors) compared to the broader population of issuer audits. For example, as shown in Figure 6, only 14 percent of audits of EGCs involved other firms compared to 27 percent of issuer audits overall.³⁵⁶ Thus, because the use of other firms 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 amendments.

³⁵⁵ *See id.* at 1. Approximately 97 percent of EGCs were audited by accounting firms that also audit issuers that are not EGCs, and 40 percent of EGC filers were audited by firms that were subject to inspection 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 16, 20. As of the November 15, 2021 measurement date, PCAOB staff identified approximately 3,100 companies that self-identified with the SEC as EGCs and filed audited financial statements in the 18 months preceding the measurement date. The increase from 2020 to 2021 is, in large part, driven by special purpose acquisition companies. Special purpose acquisition company audits rarely involve the participation of other auditors.

³⁵⁶ The analysis of Form AP data presented in Figure 6 is limited to issuers other than investment company vehicles and employee benefit plans.

Figure 6. Comparison of the Use of Other Auditors in Audits of EGCs and Issuers Overall (2021)

	Audits of EGCs	Audits of issuers overall*
Percentage of issuer audits that use other auditors	14%	26%
Percentage of audits involving other auditors where:		
2 or more other auditors were involved	35%	61%
5 or more other auditors were involved	5%	28%
Percentage of audits involving other auditors where:		
Other auditors performed 10% or more of total audit hours	40%	52%
Other auditors performed 30% or more of total audit hours	17%	19%

Source: 2021 Form AP data obtained from PCAOB's AuditorSearch database.

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

Audits of EGCs that do involve other accounting firms are also likely to involve fewer other firms than those of issuers overall. For example, as shown in Figure 6, in audits involving other accounting firms, EGC audits involve two or more other firms in about 35 percent of audits compared to about 61 percent of audits of issuers overall. The difference is more pronounced when considering the use of several other firms, where only about five percent of EGC audits involving other firms involve five or more other firms in contrast to about 28 percent of issuer audits overall.

A comparison of the share of total audit hours performed by other accounting firms shows a more modest difference between EGC audits and issuer audits overall. Measured by the share of total audit hours performed by other accounting firms, the role of other firms on EGC audits is less substantial compared to their role on audits of issuers overall. For example, as shown in Figure 6, other accounting firms perform 10 percent or more of the audit hours in about

40 percent of audits of EGCs compared to about 52 percent of audits of issuers overall. Other accounting firms perform 30 percent or more of the audit hours in about 17 percent of audits of EGCs and about 19 percent of audits of issuers overall.

These statistics suggest that, when compared to issuer audits overall, audits of EGCs are less likely to involve the use of other firms and, even when they do, they typically involve fewer other firms and those other firms account for a smaller share of total audit hours.

For individual EGC audits involving other firms, the economic impacts of the amendments may be more or less significant depending on the facts and circumstances of a particular audit. In addition to the extent of involvement of other firms, the benefits and costs also depend on the level of risk associated with the audit work performed by other firms, the current methodologies, and the ability to distribute implementation costs across engagements. EGCs are likely to be newer companies, which may increase the importance to investors of the external audit to enhance the credibility of management disclosures.³⁵⁷ All else equal, the benefits of the higher audit quality resulting from the amendments may be larger for EGCs than for non-EGCs. In particular, because investors who face uncertainty about the reliability of a company's financial statements may require a larger risk premium that increases the cost of capital to companies, the improved audit quality resulting from applying the new amendments to EGC audits involving other firms could reduce the cost of capital to those EGCs.³⁵⁸ Moreover,

³⁵⁷ 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. 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. *See* 2021 SRC at 65 notes 181 and 182.

³⁵⁸ *See* 2021 SRC at 65 note 183.

because of the scalability of the risk-based requirements, the costs of performing the procedures are unlikely to be disproportionate to the benefits of the procedures. Overall, the amendments are expected to enhance audit quality and contribute to an increase in the credibility of financial reporting by EGCs.

For the reasons explained above, the Board believes that the amendments are in the public interest and, after considering the protection of investors and the promotion of efficiency, competition, and capital formation, recommends that the amendments should apply to audits of EGCs. Accordingly, the Board recommends 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. The Board stated its readiness to assist the Commission in considering any comments the Commission receives on these matters during the Commission's public comment process.

III. Date of Effectiveness of the Proposed Rules and Timing for Commission Action

Within 45 days of the date of publication of this notice in the *Federal Register* or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Board consents, the Commission will:

- (A) by order approve or disapprove such proposed rules; or
- (B) institute proceedings to determine whether the proposed rules should be

disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rules are consistent with the requirements of Title I of the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's internet comment form (<http://www.sec.gov/regulatory-actions/how-to-submit-comments>); or
- Send an email to rule-comments@sec.gov. Please include File Number PCAOB-2022-01 on the subject line.

Paper comments:

- Send paper comments in triplicate to Vanessa Countryman, Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090.

All submissions should refer to File Number PCAOB-2022-01. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's website (<http://www.sec.gov/rules/pcaob.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rules that are filed with the Commission, and all written communications relating to the proposed rules between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549-1090, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing will also be available for inspection and copying at the principal office of the PCAOB. All comments received will be posted without change. Persons submitting comments are cautioned

that we do not redact or edit personal identifying information from comment submissions. All submissions should refer to File Number PCAOB-2022-01 and should be submitted on or before [insert 21 days from publication in the *Federal Register*].

For the Commission, by the Office of the Chief Accountant, by delegated authority.³⁵⁹

J. Matthew DeLesDernier,
Assistant Secretary.

³⁵⁹ 17 CFR 200.30-11(b)(1) and (3).



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Major Proposed
Amendments:

The Board is proposing for public comment:

- (i) To supersede:
 - AS 1205 (currently AU sec. 543), *Part of the Audit Performed by Other Independent Auditors*; and
 - AI 10, *Part of the Audit Performed by Other Independent Auditors: Auditing Interpretations of AS 1205* (currently AU sec. 9543, *Part of Audit Performed by Other Independent Auditors: Auditing Interpretations of Section 543*);

- (ii) To amend:
 - AS 1201 (currently Auditing Standard No. 10), *Supervision of the Audit Engagement*;
 - AS 1215 (currently Auditing Standard No. 3), *Audit Documentation*;
 - AS 1220 (currently Auditing Standard No. 7), *Engagement Quality Review*; and
 - AS 2101 (currently Auditing Standard No. 9), *Audit Planning*; and

- (iii) To issue a new auditing standard, AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*.



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Appendices

- 1 Proposed Amendments Relating to the Performance of Audits Involving Other Auditors
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- 3 Other Related Proposed Amendments to PCAOB Auditing Standards and Rules
- 4 Additional Discussion of Proposed Amendments and Proposed New Standard
- 5 Characteristics of Self-Identified Emerging Growth Companies



I. Executive Summary

Many companies, including many of the largest corporations, have significant international operations. In the audits of such companies, although one firm issues the audit report (*i.e.*, "lead auditor"), important audit work is often performed by other independent accounting firms or other individual accountants (collectively "other auditors").¹ This proposal addresses the lead auditor's responsibilities with respect to other auditors that participate in the audit.

In an audit conducted in accordance with PCAOB standards, the auditor plans and supervises the audit so that the work of all audit participants is properly directed and coordinated, and the results of the work are properly evaluated. When other auditors participate in an audit, it is important for investor protection that the lead auditor assure the audit is performed in accordance with PCAOB standards and that sufficient appropriate evidence is obtained through the work of the lead auditor and other auditors to support the lead auditor's opinion in the audit report.

Working with other auditors can differ significantly from working with individuals in the same firm. For example, the lead auditor and other auditors may work in countries with different business practices, languages, cultural norms, and market conditions. Also, different firms have different quality control systems, and the professional training and experience of the lead auditor may differ from those of the other auditors. These factors can pose challenges in the coordination and communication between the lead auditor and other auditors, including misunderstandings regarding the audit effort needed to meet the objectives of other auditors' work. Without adequate supervision by the lead auditor to address these challenges, deficiencies in other auditors' work can result in deficient audits. Consequently, the lead auditor could issue its audit report without a proper evaluation of the work performed and the evidence obtained in the entire audit and, in some cases, without a reasonable basis for its opinion.

In recent years, some accounting firms have made changes in how they supervise audits that involve other auditors. For example, some firms have encouraged a greater level of supervision by the lead auditor of work performed by other auditors, including frequent, comprehensive communications with other auditors and review of

¹ This release uses general meanings of "lead auditor" and "other auditors" for ease of explanation. The proposed amendments include more specific definitions of the terms for purposes of applying certain PCAOB standards, as proposed to be amended. For example, the proposed amendments specifically exclude a "referred-to auditor" from the definition of "other auditors." See, *e.g.*, proposed paragraphs .A5 and .A6 of AS 2101 (currently Auditing Standard No. 9), *Audit Planning* (defining "other auditor" and "referred-to auditor.")



other auditor work papers in areas of significant risk. The implementation of these changes to supervision by certain accounting firms appears to have contributed to improvements in the quality of work performed by other auditors.

However, other firms have not significantly changed how they supervise other auditors. In addition, observations from PCAOB oversight activities indicate that further improvements in firm practices may be needed. PCAOB staff continue to identify significant deficiencies in the work of other auditors in critical audit areas, deficiencies that lead auditors did not identify or did not address. Such findings indicate that investor protection could be improved by, among other things, increased involvement in and evaluation of the work of other auditors by the lead auditor.

Because of the lead auditor's central role in an audit involving other auditors, the Board is proposing to amend its auditing standards to strengthen the existing requirements and impose a more uniform approach to the lead auditor's supervision of other auditors. These improvements are 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. This proposal is intended to strengthen PCAOB auditing standards in the following respects:

- *Taking into account recent changes in auditing practice.* Revising PCAOB auditing standards to take into account recent changes that some firms have implemented to improve their auditing practices would serve to make certain improved practices more uniform among accounting firms for audits that involve other auditors.
- *Applying a risk-based supervisory approach.* Applying a risk-based approach to supervision could result in more appropriate involvement by the lead auditor in supervising the work of other auditors. Unlike the Board's standards for determining the scope of multi-location audit engagements and general supervision of the audit, which require more audit attention to areas of greater risk, the existing standard for using the work of other auditors, AS 1205 (currently AU sec. 543), *Part of the Audit Performed by Other Independent Auditors*, allows the lead auditor, in certain situations, to limit its involvement to certain specified procedures that are not explicitly required to be tailored for the associated risks. Applying a risk-based approach would direct the lead auditor's supervisory responsibilities to the areas of greatest risk.
- *Providing additional direction.* Providing additional direction to the lead auditor on how to apply the principles-based supervisory requirements under PCAOB standards to supervision of other auditors could help



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address the unique aspects of supervising other auditors. Additional direction also could help the lead auditor assure that its participation in the audit is sufficient for it to carry out its responsibilities and issue an audit report based on sufficient appropriate evidence.

Additionally, the Board is proposing a new auditing standard for an audit in which the lead auditor divides responsibility for the audit with another accounting firm and refers to the audit report of the other firm in the lead auditor's own audit report. This proposed new standard is designed to carry forward and improve existing requirements that apply in these relatively infrequent circumstances.

The Board is seeking comment on the proposed amendments to its standards (including the new auditing standard), alternatives to those proposed amendments, the economic impacts of the proposal, and data on current practices and potential benefits and costs. This release, including Appendix 4, contains questions on discrete aspects of these matters for which the Board seeks comment. Readers are encouraged to answer questions in the release, and to comment on any aspect of the release or the proposed amendments not covered by specific questions. Readers are especially encouraged to provide the reasoning to support their views and any relevant data.

II. Background and Reasons to Improve Auditing Standards

Many companies have significant operations in jurisdictions outside the country or region of the lead auditor. Among over 4,300 publicly listed companies that reported 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 the total assets and sales, respectively.²

When an independent public accountant audits a multinational company, the audit often necessitates the participation of firms or accountants other than the lead auditor,³ involving perhaps several other accounting firms.⁴ The work performed by other auditors can account for a significant share of the audit. For example, based on

² This data is based on information from the most recent audited financial statements of certain public companies filed as of November 15, 2015, sourced from Standard & Poor's. For a more detailed discussion of this information, see section *Geographic Segment Reporting* and note 5 in Appendix 5 of this release.

³ See Elizabeth Carson, *Globalization of Auditing*, in *The Routledge Companion to Auditing 23* (David Hay, W. Robert Knechel, and Marleen Willekens eds., 2014).

⁴ PCAOB staff analysis of inspections data indicates that the number of accounting firms involved in an audit is, in some cases, greater than 20.



PCAOB oversight data, in audits selected by the PCAOB for inspection that involve 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.⁵

The use of other auditors is especially prevalent among larger companies audited by larger accounting firms. PCAOB oversight data indicate that about 55 percent of audits performed by U.S. global network firms ("GNFs"),⁶ and about 30 percent of audits performed by non-U.S. GNFs, were engagements using other auditors.⁷ Additionally, about 80 percent of the Fortune 500 issuer audits performed by U.S. GNFs involved other auditors.⁸

Using other auditors can enable lead auditors to leverage the local workforce in the countries where their audit clients operate to assemble a global engagement team with the necessary knowledge, skill, and ability to conduct an effective audit. In addition, for audits of multinational companies, engaging other auditors allows lead auditors to

⁵ The analysis was performed on engagement-level data obtained through PCAOB oversight activities in inspection years 2013–2014. The audits inspected by the PCAOB are most often selected based on risk rather than selected randomly, and these numbers may not represent the use of other auditors across a broader population of companies. *See also 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, at n. 54 and accompanying text (Dec. 15, 2015) (referencing a PCAOB staff analysis of more than 100 large issuer audits in 2013–2014, which found that a requirement to disclose each other auditor who performed more than 5 percent of the hours on an engagement would reveal one or two other participants per audit on average).

⁶ GNFs are the member firms of the six global accounting firm networks that include the largest number of PCAOB-registered non-U.S. firms. 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 domestic and non-U.S. accounting firms registered with the Board that are not GNFs.

⁷ PCAOB staff analysis of data from Audit Analytics and Standard & Poor's. As of December 31, 2015, there were a total of 8,606 public companies trading on U.S. exchanges with an aggregate global market capitalization of about \$33 trillion. U.S. and non-U.S. GNFs audited 56 percent of these companies, which accounted for over 99 percent of global market capitalization.

⁸ Based on PCAOB staff analysis of inspections data. The Fortune 500 includes 451 issuers that are audited by U.S. GNFs, and 364 of the audits of those issuers involve other auditors.



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accept engagements they may otherwise be unable to undertake, in large part because of restrictions on the activities of foreign auditors that are imposed by many countries.⁹

At the same time, working with other auditors can differ significantly from working with individuals in the same firm. For example, the lead auditor and other auditors may work in countries with different business practices, languages, cultural norms, and market conditions. Also, different firms have different quality control systems, and the professional training and experience of the lead auditor may differ from those of the other auditors (including training and experience in applying PCAOB standards). These factors can pose challenges in the coordination and communication between the lead auditor and other auditors, including misunderstandings regarding the audit effort needed to meet the objectives of the other auditors' work. Without adequate supervision by the lead auditor to address these challenges, deficiencies in other auditors' work can result in deficient audits. Consequently, the lead auditor could issue its audit report without a proper evaluation of the work performed and the evidence obtained in the entire audit and, in some cases, without a reasonable basis for its opinion.

As discussed in Sections B and C below, PCAOB inspections continue to identify significant deficiencies in audit work performed by other auditors that lead auditors did not identify or address. However, there are indications that increased involvement by the lead auditor could enhance the quality of other auditors' work. Additionally, although some firms have made changes to improve their practices for supervising other auditors, other firms have not adopted improvements.

A. Current Requirements

This section discusses the PCAOB auditing standards that apply specifically when other auditors participate in an audit. Two of the Board's standards, which were adopted at different points in time, take different approaches to how the lead auditor supervises, or uses the work and reports of, other auditors. In 2003, the Board adopted

⁹ See, e.g., Hansrudi Lenz and Marianne L. James, *International Audit Firms as Strategic Networks—The Evolution of Global Professional Service Firms*, in *Economics and Management of Networks: Franchising, Strategic Alliances, and Cooperatives* 367, 369 (Gérard Cliquet, George Hendrikse, Mika Tuunanen, and Josef Windsperger eds., 2007) ("In most countries the right to practice as a certified audit firm is granted only to national firms in which locally qualified professionals have majority or full ownership. Therefore, member firms of an accounting network are locally owned and managed. Furthermore, the detailed national rules concerning corporate law and accounting require a high degree of local knowledge, which creates a natural barrier of entry for foreign audit firms without local knowledge.").



AU sec. 543¹⁰ (reorganized as AS 1205¹¹), *Part of Audit Performed by Other Independent Auditors*, when it adopted the auditing profession's standards in existence at that time.¹² AS 1205 imposes requirements on a lead auditor (or "principal auditor," in the terminology of AS 1205) that uses the work and reports of other independent auditors that have audited the financial statements of one or more subsidiaries, divisions, branches, components, or investments included in the financial statements audited by the lead auditor. The specific requirements vary depending upon whether the lead auditor uses the work of other auditors by (i) assuming responsibility for the other auditors' work or (ii) dividing responsibility for the audit with other auditors ("referred-to auditors") and referring to their work in the lead auditor's audit report.¹³ Those "divided responsibility" situations are relatively uncommon.

In 2010, the Board adopted Auditing Standard No. 10 (reorganized as AS 1201), *Supervision of the Audit Engagement*, when it adopted eight new auditing standards that set forth the auditor's responsibilities for assessing and responding to risk in an audit.¹⁴ AS 1201 governs the supervision of the audit engagement, including

¹⁰ In 1963, the American Institute of Certified Public Accountants ("AICPA") issued a codification of auditing standards that included several paragraphs on the use of other auditors' work. In 1971, the AICPA issued Statement on Auditing Procedure No. 45, *Using the Work and Reports of Other Auditors*, and in 1972 it codified the standard in section 543 of the Statement on Auditing Standards No. 1.

¹¹ In 2015, the PCAOB adopted and the U.S. Securities and Exchange Commission ("SEC") approved the reorganization of PCAOB auditing standards using a topical structure and a single, integrated numbering system. See *Reorganization of PCAOB Auditing Standards and Related Amendments to PCAOB Standards and Rules*, PCAOB Release No. 2015-002 (Mar. 31, 2015); SEC, *Public Company Accounting Oversight Board; Order Granting Approval of Proposed Rules To Implement the Reorganization of PCAOB Auditing Standards and Related Changes to PCAOB Rules and Attestation, Quality Control, and Ethics and Independence Standards*, Exchange Act Release No. 75935 (Sept. 17, 2015), 80 FR 57263 (Sept. 22, 2015). The reorganized amendments will be effective as of December 31, 2016, but may be used and referenced before that date. See PCAOB Release No. 2015-002, at 21.

¹² See *Establishment of Interim Professional Auditing Standards*, PCAOB Release No. 2003-006 (Apr. 18, 2003).

¹³ For example, the lead auditor may divide responsibility for the audit with the other auditor if it is impracticable for the lead auditor to review the other auditor's work. See AS 1205.06.

¹⁴ *Auditing Standards Related to the Auditor's Assessment of and Response to Risk and Related Amendments to PCAOB Standards*, PCAOB Release No. 2010-004 (Aug. 5, 2010). These "risk assessment standards" set forth requirements for the



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supervising the work of engagement team members. Under existing PCAOB standards, the lead auditor supervises the work of another auditor under AS 1201 in situations not covered by AS 1205. AS 1205 provides that in "situations in which the auditor engages an accounting firm or individual accountants to participate in the audit engagement and AS 1205 does not apply, the auditor should supervise them in accordance with the requirements of AS 1201"¹⁵

The Board's risk assessment standards largely left in place the preexisting requirements for using the work of other auditors under AS 1205. When the Board adopted the risk assessment standards, it noted that it would likely address the use of other auditors under that approach at a later time.¹⁶

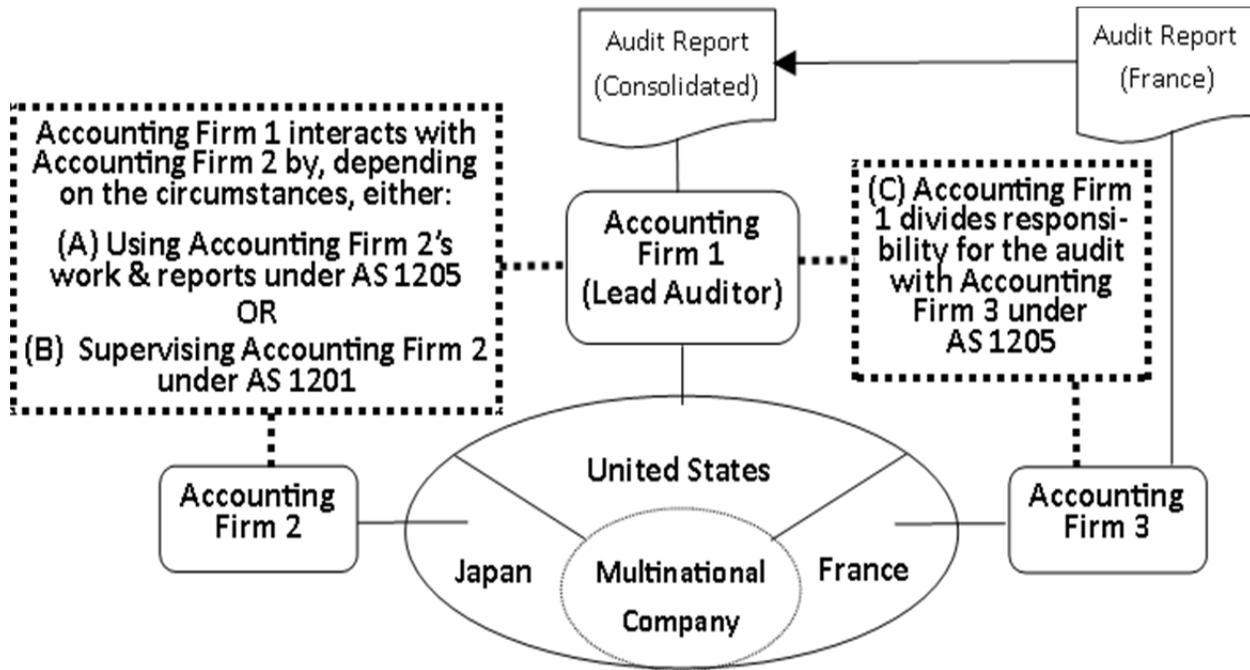
Figure 1 illustrates an example of a U.S.-based audit that involves other auditors, and the PCAOB auditing standards that apply to the audit. In the example, Accounting Firm 1 involves Accounting Firm 2 by (A) assuming responsibility for the work and reports of Accounting Firm 2 in accordance with AS 1205 or (B) supervising the work of Accounting Firm 2 in accordance with AS 1201. The lead auditor (C) divides responsibility for part of the audit with Accounting Firm 3 in accordance with AS 1205 and refers to Accounting Firm 3 in the lead auditor's audit report on the consolidated financial statements.

auditor's assessment of, and response to, the risks of material misstatement in the financial statements. Among other things, the risk assessment standards established risk-based requirements for determining the necessary audit work in multi-location audit engagements.

¹⁵ See the second note to AS 1205.01. For example, AS 1205 does not apply when the participation of another accounting firm in an audit consists solely of observing a physical inventory at a company's warehouse.

¹⁶ See PCAOB Release No. 2010-004, at A10-19 ("[T]he Board has [a] separate standards-setting [project] regarding ... [the use of other auditors], which will include comprehensive reviews of ... AU sec. 543 [reorganized as AS 1205] ... in light of, among other things, observations from the Board's inspection activities ... [and] will likely result in changes to the auditor's responsibilities regarding the auditor's ... use of other auditors, and, in turn, may result in changes to Auditing Standard No. 10 [reorganized as AS 1201].").

Figure 1. Example of an Audit Involving Other Auditors



The following discusses AS 1205 and AS 1201 in more detail:

(A) *Using the work and reports of other auditors under AS 1205 (currently AU sec. 543).* If an auditor uses, and assumes responsibility for, the work and reports of other auditors that audited the financial statements of one or more subsidiaries, divisions, branches, components, or investments included in the financial statements presented, AS 1205 includes the following requirements:¹⁷

- When significant parts of the audit are performed by other auditors (from the same network of firms as the lead auditor or outside the network), the auditor is required to decide whether its own

¹⁷ In addition, in situations governed by AS 1205, the lead auditor is required by the Board's standard on planning, AS 2101, *Audit Planning*, to determine the locations or business units at which audit procedures should be performed. This also applies to situations in which the auditor divides responsibility with another accounting firm. See AS 2101.14.

participation in the audit is sufficient for it to serve as the lead auditor (or, in the language of AS 1205, the "principal auditor").¹⁸

- The lead auditor is required to make inquiries about the qualifications and independence of the other auditor and to ascertain through communication with the other auditor:
 - That the other auditor is aware that the financial statements of the component which he or she is to audit are to be included in the financial statements on which the lead auditor will report and that the other auditor's report will be relied upon by the lead auditor;
 - That the other auditor is familiar with the accounting principles generally accepted in the United States, standards of the PCAOB, and relevant financial reporting requirements; and
 - That a review will be made of matters affecting elimination of intercompany transactions and accounts.¹⁹
- The lead auditor must obtain, review, and retain certain information from the other auditor before issuing the report, including an engagement completion document, a list of significant risks, the other auditor's responses to those risks, the results of the other auditor's related procedures, and significant deficiencies and material weaknesses in internal control over financial reporting.²⁰
- The lead auditor also should consider performing one or more of the following procedures: visiting the other auditor, reviewing the audit programs of the other auditor (and, in some cases, issuing instructions to the other auditor), and reviewing additional audit documentation of significant findings or issues in the engagement completion document.²¹

¹⁸ AS 1205.02.

¹⁹ AS 1205.10.c.

²⁰ See AS 1205.12.

²¹ *Id.*

- (B) *Including the other auditors in the engagement team and supervising their work under AS 1201.* This standard governs the auditor's supervision of an audit engagement, including the work of other auditors who are members of the same engagement team, wherever they are located. AS 1201, as it relates to the supervision of other auditors on the engagement team, contains these requirements:
- The engagement partner and others who assist the engagement partner in supervising the audit should:
 - Inform the engagement team members of their responsibilities for the work they are to perform;
 - Direct the engagement team members to inform the engagement partner and supervisors of important issues arising during the audit; and
 - Review the engagement team members' work.²²
 - The engagement partner and others who assist the engagement partner in supervising the audit should determine the extent of supervision necessary. Under this standard, requirements for supervision are risk-based and scalable, and the necessary extent of supervision varies depending on, for example, the associated risks of material misstatement, the nature of the work performed, and the qualifications of individuals involved.²³
 - The engagement partner may seek assistance from other appropriate engagement team members in fulfilling his or her supervisory responsibilities ("supervisory team members").²⁴ The supervisory team members can be from the partner's firm or from outside the firm.
- (C) *Dividing responsibility for the audit with another accounting firm.* AS 1205 also governs audits in which the lead auditor divides responsibility with another accounting firm that issues a separate audit report on the financial statements of one or more subsidiaries, divisions, branches, components,

²² See AS 1201.05.

²³ See AS 1201.06.

²⁴ See AS 1201.04.



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or investments included in the company's financial statements.²⁵ The requirements of AS 1205 that apply under these circumstances are more limited than the requirements that apply to the lead auditor's use of the work and reports of other auditors when the lead auditor assumes responsibility for that work (discussed in item A above). For example, AS 1205 does not require the lead auditor to obtain, review, and retain certain information from the accounting firm with which the lead auditor divides responsibility for the audit (which is required when the lead auditor assumes responsibility for another firm's work under AS 1205²⁶).

B. Current Practice

This section describes the state of practice – including the evolution of audit practices and related inspection findings – that the Board and its staff have observed over the past several years through PCAOB oversight activities (including through observations from audit inspections and enforcement cases). Section C discusses the reasons for change that underlie the amendments the Board is proposing.

1. Evolution of Auditing Practice at Accounting Firms

Auditors around the world, even when they perform audit procedures that are required to comply with PCAOB standards, may be influenced by international and home country auditing standards. With respect to the use of other auditors, the standards of the International Auditing and Assurance Standards Board ("IAASB") and the AICPA's Auditing Standards Board ("ASB"), (International Standard on Auditing ("ISA") 600²⁷ and AU-C Section 600²⁸), establish requirements for "group audits."²⁹ ISA 600 and AU-C Section 600 were developed in the wake of several significant frauds that

²⁵ In these situations, SEC rules require that the other accounting firm's report be filed with the SEC. See Rule 2-05 of Regulation S-X, 17 C.F.R. 210.2-05.

²⁶ See AS 1205.12.

²⁷ ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, effective for audits of group financial statements for periods beginning on or after December 15, 2009.

²⁸ AU-C Section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, effective for audits of group financial statements for periods ending on or after December 15, 2012.

²⁹ Under ISA 600 and AU-C 600, group audits are audits of "group financial statements" consisting of at least two "components." Group audits generally are performed by a "group engagement team" and one or more "component auditors" and may involve a single firm or multiple firms.



occurred in the early 2000s and involved multinational groups of companies, audited by multiple accounting firms.³⁰

The IAASB is continuing to assess the need for change in this area. Recently, the IAASB issued a request for comment on identified areas of potential improvement in the standards for group audits,³¹ which was informed by, among other things, persistent deficiencies in group audits reported by the International Forum of Independent Audit Regulators.³²

Meanwhile, the Board has observed through its oversight activities that, after the PCAOB adopted its standards on risk assessment and after the IAASB and ASB issued their new standards, some accounting firms, particularly some of the largest firms that work extensively with other auditors, revised their policies, procedures, and guidance ("methodologies") for using other auditors. These methodologies are based primarily on the requirements of ISA 600 and include certain other procedures for audits under PCAOB standards.³³ The Board also observed differences among firms' methodologies,

³⁰ See, e.g., *Koninklijke Ahold N.V. (Royal Ahold)*, A. Michiel Meurs and Cees van der Hoeven, and Johannes Gerhardus Andreae, SEC Accounting and Auditing Enforcement Release ("AAER") No. 2124 (Oct. 13, 2004); *Lernout & Hauspie Speech Products*, AAER No. 1729 (Mar. 4, 2003); *Lernout & Hauspie Speech Products*, AAER No. 1648 (Oct. 10, 2002); *In re Parmalat Securities Litigation*, 04 Civ. 0030 (S.D.N.Y. June 28, 2005). See also Michael J. Jones, ed., *Creative Accounting, Fraud and International Accounting Scandals* (2011) (Part B of the book covers 58 high-profile accounting scandals across 12 countries, including the Royal Ahold and Parmalat cases).

³¹ See IAASB, *Invitation to Comment, Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits* (Dec. 2015). See also IAASB, *Work Plan for 2015–2016: Enhancing Audit Quality and Preparing for the Future* (Dec. 2014), 7 ("Concern [with ISA 600] has been expressed about: [t]he extent of the group auditor's involvement in the work of the component auditor ...; [c]ommunication between the group auditor and the component auditor; [a]pplication of the concept of component materiality; [i]dentifying a component in complex situations; and [w]ork effort of the component auditor.").

³² See paragraph 7 of IAASB, *Invitation to Comment, Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits* (Dec. 2015).

³³ For example, for audits under PCAOB standards, these methodologies often require engagement teams to determine the sufficiency of the firm's participation in the audit. See also Appendix 4 of this release, which compares the Board's proposed amendments to the analogous standards of the IAASB and ASB.



for example, in their approaches to determining whether the firm's participation in an audit is sufficient for it to serve as lead auditor.

In addition, some firms have added requirements that in some respects go beyond those of PCAOB, IAASB, and ASB standards. Other firms, however, have maintained methodologies generally based on AS 1205.³⁴

2. Observations from Audit Inspections and Enforcement Cases

PCAOB staff have inspected the work of auditors who use other auditors, for example, by reviewing the scope of the work that is performed by the other auditor, the planning and instructions provided to the other auditor, and the degree of supervision (including review) of the other auditor. The PCAOB also has inspected the work of other auditors, for example, when it conducts inspections abroad and reviews work performed by non-U.S. auditors at the request of a U.S.-based lead auditor. In some cases, PCAOB staff have inspected the work performed by both the lead auditor and other auditors on the same audit. In many cases, but not always, the lead auditor was a U.S. firm while the other auditor was located in another jurisdiction. Observations regarding the work of lead auditors and other auditors from inspections and enforcement actions are described in more detail below.

(i) Other Auditors

Over the past several years, PCAOB inspections staff have observed significant audit deficiencies in the work performed by other auditors. For example, in 2013, inspections staff identified significant audit deficiencies in more than 40 percent³⁵ of the inspected work performed for lead auditors by non-U.S. GNFs. According to a recent analysis, the rate of deficiencies in inspected audits in 2011–2013 was generally higher for non-U.S. GNFs than for U.S. GNFs.³⁶

³⁴ See Section IV.A.3 below for a more detailed discussion of the methodologies.

³⁵ The rates in 2011-2013 were 32, 38, and 42 percent, respectively. See *Audit Committee Dialogue*, PCAOB Release No. 2015-003, at 9 (May 7, 2015) (graph entitled "Deficiencies in Non-U.S. Referred Work"). The issuer audit engagements and aspects of the work inspected are selected based on a number of risk-related and other factors. Due to the selection process, the deficiencies included in inspections reports are not necessarily representative of the inspected firms' issuer audit engagement practice.

³⁶ See Lewis H. Ferguson, *Big Four Audit Quality Can Differ Widely — Even at the Same Firm* (Nov. 17, 2015) (Mr. Ferguson is a Board member of the PCAOB).



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Inspections of the work performed by other auditors have revealed deficiencies such as noncompliance with the lead auditor's instructions and failure to communicate significant accounting and auditing issues to the lead auditor. In addition, deficiencies have been identified in other auditors' compliance with other PCAOB standards governing a variety of audit procedures. These failures in audit performance occurred in critical audit areas that are frequently selected for inspection, including revenue, accounts receivable, internal control over financial reporting, and accounting estimates including fair value measurements. For example, in a number of instances, other auditors failed to perform sufficient procedures in auditing the revenue of a company's business unit, including, with respect to evaluating the revenue recognition policy of a business unit, testing the occurrence of revenue, and testing the operating effectiveness of the business unit's controls over revenue. In a recent Board enforcement case, one other auditor failed both to ensure he was technically proficient and to supervise his assistants in accordance with PCAOB standards.³⁷ More recently, however, there are some indications of decreasing inspection-observed deficiencies, as discussed in Section II.B.2(iv) below.

(ii) Lead Auditor

Over the years, there have been numerous observations from inspections and enforcement activities where 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. These deficiencies occurred at large and small firms, domestic as well as international. In the most egregious examples, the lead auditor failed to perform an audit or participated very little in the audit and instead issued an audit report on the basis of procedures performed by other auditors.³⁸ In these audits, the auditor failed to appropriately determine that it could serve as the lead auditor when all or a substantial portion of the financial statements were audited by another auditor.

³⁷ See *Akiyo Yoshida, CPA*, PCAOB Release No. 105-2014-024 (Dec. 17, 2014).

³⁸ For enforcement cases, see, e.g., *Michael T. Studer, CPA, P.C. and Michael T. Studer, CPA*, PCAOB Release No. 105-2012-007 (Sept. 7, 2012); *Bentleys Brisbane Partnership and Robert John Forbes, CA*, PCAOB Release No. 105-2011-007 (Dec. 20, 2011); *Dohan + Company, CPAs, Steven H. Dohan, CPA, Nancy L. Brown, CPA, and Erez Bahar, CA*, SEC AAER No. 3232 (Jan. 20, 2011). Some of the standards violated in the enforcement cases cited in this release were predecessor standards to current PCAOB standards. The descriptions of inspection deficiencies are based on certain accounting firm inspection reports (portions of which are available on the PCAOB's website), and on the PCAOB's experience with inspecting different firms.



There also have been findings in which the lead auditor failed to assess, or adequately assess, the qualifications of other auditors' personnel who participated in the audit. For example, PCAOB oversight activities have revealed situations in which the other auditors' personnel lacked the necessary industry experience or knowledge of PCAOB and SEC rules and standards (including independence requirements) and the applicable financial reporting framework to perform the work requested by the lead auditor. Other examples include audits in which: (i) the lead auditor failed to obtain, review, and retain the results of the other auditor's procedures relating to fraud risk factors;³⁹ (ii) the lead auditor failed to provide specific instructions to other auditors, including detailed audit plans, appropriate modifications to audit plans based on identified risks, the audit objectives to be accomplished, or the need to maintain proper documentation;⁴⁰ and (iii) the lead auditor failed to adequately supervise the work of foreign audit staff, in circumstances in which the engagement partner did not speak, read, or write the language used by the foreign staff.⁴¹ More recently, there are indications of increased involvement by some firms in the supervision of other auditors, as discussed in Section II.B.2(iv) below.

(iii) Divided Responsibility Audits

Audits in which the lead auditor divides responsibility with one or more other accounting firms are relatively uncommon.⁴² Such division of responsibility between auditors might occur, for example, in the year when an issuer acquires a company

³⁹ See *Ron Freund, CPA*, PCAOB File No. 105-2009-007, at 1 (Jan. 26, 2015) (citing a violation of AU sec. 543.12b (reorganized as AS 1205.12b) and observing that "the principal auditor must obtain, and review and retain, the following information from the other auditor: ... b. A list of significant fraud risk factors, the auditor's response, and the results of the auditor's related procedures").

⁴⁰ See, e.g., *Child, Van Wagoner & Bradshaw, PLLC, Russell E. Anderson, CPA, and Marty Van Wagoner, CPA*, SEC AAER No. 3637 (Feb. 11, 2015); *Sherb & Co., LLP, Steven J. Sherb, CPA, Christopher A. Valleau, CPA, Mark Mycio, CPA, and Steven N. Epstein, CPA*, SEC AAER No. 3512 (Nov. 6, 2013).

⁴¹ See, e.g., *Acquavella, Chiarelli, Shuster, Berkower & Co., LLP*, PCAOB Release No. 105-2013-010 (Nov. 21, 2013); *David T. Svoboda, CPA*, PCAOB Release No. 105-2013-011 (Nov. 21, 2013).

⁴² Based on PCAOB staff analysis of SEC filings as of May 26, 2015, Form 10-K filings showed approximately 30 and 38 audits in which the lead auditor divided responsibility with another auditor in fiscal years 2014 and 2013, respectively. Form 20-F filings showed approximately 20 such audits in each of fiscal years 2014 and 2013.



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audited by another auditor.⁴³ Because divided responsibility audits are infrequent, they have not been a significant focus of PCAOB inspections and have not resulted in significant findings.

(iv) Evolution of Inspection Findings

As noted above, some firms, particularly larger firms affiliated with global networks, have increased their supervision of other auditors in light of new standards such as ISA 600 and AU-C Section 600. More recently, some larger U.S. firms have made further changes to their audit methodologies in response to deficiencies identified by PCAOB inspections. Specifically, some firms have encouraged a greater level of supervision by the lead auditor, such as frequent comprehensive communications with other auditors and review of other auditors' work papers in the areas of significant risk.

There are some preliminary indications from the Board's inspections that these firms' recent revisions to methodologies to increase the lead auditor's supervision of the other auditor's work may have contributed to a decline in inspection-observed audit deficiencies at foreign affiliates of those firms with respect to work these affiliates perform at the lead auditor's request. In 2014, for example, PCAOB inspections staff observed a decrease in the number of significant audit deficiencies in work performed by other auditors. Thus, the changes to the methodologies of some firms appear to have contributed to some improvements in the quality of audits. However, not all firms have significantly changed their methodologies. Also, PCAOB staff continue to identify significant deficiencies in the work of lead auditors related to the lead auditors' use of other auditors, and deficiencies in the work of other auditors in the U.S. and abroad.

C. Reasons to Improve Auditing Standards

After AS 1205 was originally issued, the increasing globalization of business, especially among large public companies, has led to expanded use of other auditors and increasingly significant roles for other auditors within the audit. When other auditors participate in an audit, it is important for investor protection that the lead auditor assure that the audit is performed in accordance with PCAOB standards and that sufficient appropriate evidence is obtained through the work of the lead auditor and other auditors to support the lead auditor's opinion in the audit report. Among other things, this means that the lead auditor should be appropriately involved in the audit so that the work of all audit participants is properly supervised, and so that the results of the work are properly evaluated. Lack of adequate lead auditor supervision can result in deficient audits.

⁴³ See, e.g., SEC, Form 10-K for American Airlines Group, Inc., Annual Report for the Fiscal Year Ended December 31, 2013 (Feb. 27, 2014), at 96.



As noted above, some firms have made changes in their audit methodologies regarding the use of other auditors. However, other firms that have not made significant improvements may have greater risk of lower quality audits when they use other auditors.

Additionally, observations from PCAOB oversight activities indicate that further improvements may be needed. PCAOB staff continue to identify deficiencies in the work of other auditors in critical audit areas, deficiencies that lead auditors had not identified or sufficiently addressed. In some cases, these deficiencies occurred even when lead auditors did not violate existing requirements related to the use of other auditors, for example if the lead auditor performed the procedures described in AS 1205 but did not identify these deficiencies. Such findings indicate that investor protection could be improved by, among other things, increased involvement in, and evaluation of, the work of other auditors by the lead auditor.

In order to enhance audit practice among all firms using other auditors, the Board has identified the following areas of potential improvement in the current standards:

- *Taking into account recent changes in auditing practice.* Revising PCAOB auditing standards to take into account recent changes that some firms have implemented to improve their auditing practices would serve to make certain improved practices more uniform among accounting firms for audits that involve other auditors. Including these approaches in the auditing standards also would enable the PCAOB to enforce more rigorous provisions for audits that involve other auditors.
- *Applying a risk-based supervisory approach.* Applying a risk-based approach to supervision could result in more appropriate involvement by the lead auditor in supervising the work of other auditors. Unlike the Board's standards for determining the scope of multi-location audit engagements and general supervision of the audit, which require more audit attention to areas of greater risk, the existing standard for using the work of other auditors allows the lead auditor, in certain situations, to limit its involvement to certain specified procedures that are not explicitly required to be tailored for the associated risks. Applying a risk-based approach would direct the lead auditor's supervisory responsibilities to the areas of greatest risk.
- *Providing additional direction.* Providing additional direction to the lead auditor on how to apply the principles-based supervisory requirements under PCAOB standards to supervision of other auditors could help address the unique aspects of supervising other auditors. Additional direction also could help the lead auditor assure that its participation in the



audit is sufficient for it to carry out its responsibilities and issue an audit report based on sufficient appropriate evidence.

Because of the lead auditor's central role in an audit involving multiple firms, the Board's proposal seeks to strengthen the existing requirements and impose a more uniform approach to the lead auditor's supervision of other auditors. These improvements are intended to increase the lead auditor's involvement in and evaluation of the work of other auditors generally, 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.

Question:

1. Does the description of existing audit practice accurately depict the state of practice? Does the discussion of the reasons to improve auditing standards sufficiently describe the nature of concerns arising from the use of other auditors that the Board should address? Are there additional concerns that the Board should seek to address?

III. Discussion of Proposed Amendments

As described in more detail in Appendix 4, in its proposal the Board intends to strengthen the requirements for lead auditors and provide a more uniform approach to supervision in audits that involve other auditors.⁴⁴ The Board's approach in this proposal has been informed by, among other things: (i) observations from Board oversight of firms' current practice; (ii) the IAASB's and ASB's auditing standards and IAASB's post-implementation review;⁴⁵ (iii) views expressed by members of the Board's Standing Advisory Group ("SAG"), who have expressed concerns about the robustness of PCAOB auditing standards governing the use of other auditors;⁴⁶ and (iv) views

⁴⁴ The proposed amendments would apply to audits of issuers, as defined in Section 2(a)(7) of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley") (15 U.S.C. 7201(a)(7)), and to audits of brokers and dealers, as defined in Sections 110(3)–(4) of Sarbanes-Oxley (15 U.S.C. 7220(3)–(4)). As discussed further in this release, the PCAOB is seeking comment on whether the proposed amendments should apply to audits of emerging growth companies (see Section V below and Appendix 5) and to audits of brokers and dealers (see Section VI below).

⁴⁵ See IAASB, *Clarified International Standards on Auditing—Findings From The Post-Implementation Review* (July 2013).

⁴⁶ See the segment of the archived webcast on responsibilities of the principal auditor at the April 7–8, 2010 SAG meeting, available on the PCAOB's website.



expressed by members of a working group of the Board's Investor Advisory Group ("IAG"), who recommended stronger PCAOB auditing standards for the supervision of global audits involving other auditors.⁴⁷

Key aspects of the proposed changes are discussed in this section. The ways in which the proposed amendments would address the need for change from an economic perspective are discussed below in Section IV. In addition, Appendix 4 of this release discusses in more detail the proposed amendments and the proposed new standard.

In brief, the Board's proposal would make the following changes to PCAOB auditing standards:

A. Amend Existing Requirements

- Amend AS 1201 (Supervision). The proposal would amend AS 1201 to provide additional direction to the lead auditor on how to apply the principles-based provisions of AS 1201 to supervision of other auditors. Specifically, the proposed amendments would prescribe certain procedures to be performed by the lead auditor with respect to the supervision of the other auditor's work. Under the proposal, the lead auditor would remain responsible for the supervision of the entire audit.
- Amend AS 2101 (Planning). The proposal includes a number of amendments to AS 2101. In general, these amendments incorporate and update requirements from AS 1205 (which is proposed to be superseded), and amend existing requirements to specify that they be performed by the lead auditor. For example, the proposal would incorporate and revise the requirements in AS 1205 for determining the firm's sufficiency of participation in an audit that involves other auditors.
- Amend AS 1215 (Documentation). The proposal would amend AS 1215 to require that the documentation of the office of the firm issuing the auditor's report contain a specified list of other auditors' working papers reviewed by the lead auditor but not retained by the lead auditor.

⁴⁷ See the segment of the archived webcast and accompanying presentation slides on global networks and audit firm governance at the March 16, 2011, IAG meeting available on the PCAOB's website. In addition, at least one comment submitted to the Board in connection with another standard-setting project recommended more rigorous requirements for the planning and supervision of audits involving other auditors. See Letter from the New York State Society of Certified Public Accountants to the Office of Secretary, PCAOB (Feb. 4, 2014) (regarding PCAOB Rulemaking Docket No. 029).

- Amend AS 1220 (Engagement Quality Review). The proposal includes an amendment to AS 1220, which would specifically require the engagement quality reviewer, in an audit involving other auditors or referred-to auditors, to evaluate the engagement partner's determination of his or her firm's sufficiency of participation in the audit.
- To operationalize the proposed requirements, the proposal includes definitions of "engagement team," "lead auditor," "other auditor," and "referred-to auditor." The proposed definitions would be included in AS 1201, AS 2101, and proposed AS 1206.
- The proposal would supersede AS 1205 and thus eliminate the ability of auditors to use the work and reports of other auditors under the requirements of that standard. Thus, if the proposal were adopted, the lead auditor would be required to supervise other auditors under AS 1201 (as it would be amended), the risk-based auditing standard on supervision, when the lead auditor assumes responsibility for the other auditor's work.

B. Propose a New Auditing Standard for Dividing Responsibility

The Board is proposing a new, separate standard, AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*, to govern circumstances in which the lead auditor divides responsibility for the audit with, and makes reference in the audit report to, another firm ("referred-to auditor"). Currently, AS 1205, which the proposal would supersede, governs those circumstances. Proposed AS 1206 would maintain the requirement that the lead auditor disclose in its report which portion of the financial statements was audited by the referred-to auditor.

In general, the proposed new standard would retain, with modifications, many existing requirements of AS 1205 concerning the lead auditor and referred-to auditor (or, in the terminology of AS 1205, the "principal auditor" and the other auditor with whom the principal auditor divides responsibility for the audit). The proposed new standard would also provide new and substantially revised requirements, such as:

- Obtaining a representation from the referred-to auditor that the referred-to auditor is duly licensed to practice under the laws of the jurisdiction that apply to the work of the referred-to auditor;
- If the referred-to auditor would play a substantial role in the preparation or furnishing of the lead auditor's report, determining whether the referred-to auditor is registered pursuant to the rules of the PCAOB; and

- Disclosing the name of the referred-to auditor in the lead auditor's report.⁴⁸

The proposed modifications are designed to strengthen existing requirements, improve communication between the lead auditor and referred-to auditors, and improve compliance with ethics, independence, and PCAOB registration requirements.

Questions:

2. Are these proposed amendments to existing standards appropriate? Are additional changes needed to increase the likelihood that the lead auditor is sufficiently involved in the other auditor's work? Should the Board require specific procedures to address business, language, cultural, and other differences between lead auditors and other auditors, and if so, what types of procedures?
3. Are there any other areas of improvement in existing standards relating to audits that involve other auditors that the Board should address? Should the Board's standards be amended to address other responsibilities of the lead auditor? Are there related areas of practice for which additional or more specific requirements are needed, such as determining tolerable misstatement for the individual locations or business units under AS 2105?

IV. Economic Analysis

The Board is mindful of the economic impacts of its standard setting. The economic analysis describes the baseline for evaluating the economic impacts of the proposal, analyzes the need for the proposal, and discusses potential economic impacts of the proposed requirements, including the potential benefits, costs, and unintended consequences. The analysis also discusses alternatives considered. Because there are limited data and research findings available to estimate quantitatively the economic impacts of discrete changes to auditing standards, the Board's economic discussion is qualitative in nature.

A. Baseline

This section discusses the economic circumstances and auditing practices that exist today. It addresses: (i) the prevalence of audits involving other auditors and the relative significance of the share of audit work performed by other auditors; (ii) the current requirements that apply to the use of other auditors; (iii) the practices adopted

⁴⁸ Additionally, SEC rules require that the audit report of the referred-to auditor be filed with the SEC. See Regulation S-X Rule 2-05.



by accounting firms that use other auditors; and (iv) the quality of audits that use other auditors, based on observations from regulatory oversight and academic literature.

1. Prevalence and Significance of Audits Involving Other Auditors

The use of other auditors to perform audits is widespread, particularly in multinational companies. As discussed in Section II, many companies have significant operations in jurisdictions outside the country or region of the lead auditor. For example, among over 4,300 publicly listed companies sourced from Standard & Poor's that reported 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 the total assets and sales, respectively.⁴⁹

When an audit is performed for a multinational company, the audit often necessitates the participation of firms or accountants other than the lead auditor, involving perhaps several other accounting firms.⁵⁰ Academic research indicates that in geographically distributed audits, auditors can compete more effectively in local markets, use location-specific or culture-specific knowledge, and reduce costs by using local labor, which can be less expensive or more specialized (or both). This is particularly true for multinational audits, because engaging other auditors allows lead auditors to accept engagements they may otherwise be unable to undertake.⁵¹

The use of other auditors is especially prevalent among larger companies audited by larger accounting firms. Recent PCAOB oversight data indicate that about 55 percent of audits performed by U.S. global network firms (*i.e.*, GNFs)⁵² and about 30 percent of audits performed by non-U.S. GNFs were engagements using other auditors.⁵³ The use of other auditors is particularly prevalent among audits of the largest companies, where about 80 percent of Fortune 500 issuer audits performed by U.S. GNFs involved other auditors.⁵⁴

The work performed by other auditors in the locations away from the lead auditor can also account for a significant share of the audit. PCAOB oversight data, for

⁴⁹ See note 2 above.

⁵⁰ See note 4 above.

⁵¹ See note 9 above.

⁵² See note 6 above.

⁵³ See note 7 above.

⁵⁴ See note 8 above.



example, indicates that, in audits selected by the PCAOB for inspection that involve 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.⁵⁵

2. PCAOB Auditing Standards

As discussed above in Section II.A, two PCAOB auditing standards, AS 1205 and AS 1201, establish requirements for the lead auditor's use or supervision, respectively, of other auditors that participate in an audit. AS 1205 applies when the auditor uses the work and reports of another independent auditor who has audited the financial statements of one or more subsidiaries, divisions, branches, components, or investments included in the financial statements presented. AS 1205 allows the lead auditor (or "principal auditor," in the terminology of AS 1205) to use the results of the other auditor's work after performing specified but limited procedures. When AS 1205 does not apply, the lead auditor is required to supervise the other auditors under AS 1201, which describes supervisory activities necessary for proper supervision of engagement team members. AS 1201 does not have specific provisions for the supervision of other auditors beyond those for supervision of other members of the engagement team, and generally does not specify particular responsibilities that the lead auditor (rather than other auditors who assist the lead auditor) is required to perform.

3. Accounting Firm Methodologies

Some accounting firms, particularly large firms affiliated with global networks, employ methodologies (*i.e.*, policies, procedures, and guidance) primarily based on group audits under ISA 600 and AU-C Section 600. Recently, some of those firms have made changes to their methodologies that, in some respects, go beyond requirements in existing auditing standards. Other accounting firms have maintained methodologies based on AS 1205.

The Board's oversight activities have led to the observation that audit firm methodologies governing the supervision of audits involving other auditors vary, but can be generally grouped into the following three categories.⁵⁶

⁵⁵ See note 5 above.

⁵⁶ Although the firm's methodologies described in this section may be generally based on AS 1205 or international standards, they also generally allow other auditors to be supervised by the lead auditor in accordance with AS 1201.



(i) Approaches generally based on AS 1205. Some accounting firms, mostly small firms, have methodologies that generally are based on AS 1205. Key provisions of AS 1205 include requirements that the auditor:

- Determine whether the firm has sufficiently participated in the audit to enable it to serve as lead auditor (or "principal auditor," in the terminology of AS 1205) and report as such on the financial statements;
- Determine whether to assume responsibility for, or make reference in the lead auditor's report to, the work and report of the other auditor;
- Perform certain specified procedures, depending on whether the lead auditor assumes responsibility for the other auditor's work or divides responsibility for the audit with the other auditor, including:
 - Making inquiries concerning the professional reputation and independence of the other auditor (when assuming responsibility or dividing responsibility);
 - Adopting appropriate measures to assure the coordination of the lead auditor's activities with those of the other auditor in order to achieve a proper review of matters affecting the consolidating or combining of accounts in the financial statements (when assuming responsibility or dividing responsibility); and
 - Obtaining and reviewing certain information and documentation from the other auditor (only when assuming responsibility).

(ii) Approaches based primarily on international standards. Some accounting firms have methodologies that are based primarily on the requirements of ISA 600 and include certain other procedures for audits under PCAOB standards.⁵⁷ These methodologies often require greater involvement with the work performed by other auditors⁵⁸ than AS 1205 requires.⁵⁹

⁵⁷ For example, for audits under PCAOB standards, these methodologies often require engagement teams to determine the sufficiency of the firm's participation in the audit.

⁵⁸ The methodologies that are based on ISA 600 and AU-C Section 600 typically use terms such as "group engagement team" and "component auditors," which may (or may not) refer to separate accounting firms. This release, which focuses on how these methodologies apply to audits involving other auditors, will use the terms "lead auditor" and "other auditor" to describe the methodologies.

⁵⁹ See Appendix 4 of this release, which compares the Board's proposed amendments to the analogous standards of the IAASB and ASB.



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(iii) Approaches that specify incremental responsibilities of the lead auditor. In the past few years, some large firms have made changes to their methodologies by requiring that the lead auditor perform or consider certain supervisory procedures, beyond AS 1205 and existing international auditing standards, including, for example, procedures to:

- Evaluate specific information about the education and professional experience of the other auditors when gaining an understanding of the other auditor's qualifications;
- Continually update the understanding of the other auditors' qualifications throughout the audit and, if necessary, adjust the extent of the lead auditor's supervision of the other auditors;
- Have the lead auditor's senior engagement team members communicate throughout the audit with the other auditors about important matters that could affect the procedures to be performed by the other auditors; and
- Review specified documentation prepared by the other auditors relating to the planned audit procedures and results of the other auditors' work.

Although practices of engagement teams may differ even within the same firm due to differences in the facts and circumstances of the audit or different auditor judgments, the three categories noted here can serve as useful benchmarks for describing the expected economic impacts of the proposal, discussed below in Section IV.C.

4. *Quality of Audits That Use Other Auditors*

As discussed above in Section II.B.2, PCAOB and SEC oversight of the work performed by other auditors has revealed deficiencies, including noncompliance with the lead auditor's instructions and failure to communicate significant findings or issues to the lead auditor. In addition, deficiencies were identified in other auditors' compliance with other PCAOB standards governing a variety of audit procedures, including in critical audit areas that are usually selected for inspection, such as revenue, accounts receivable, internal control over financial reporting, and accounting estimates including fair value measurements.

Oversight of lead auditors has also resulted in inspection and enforcement observations that the lead auditor failed, under existing PCAOB standards, to appropriately determine the sufficiency of its participation in an audit, and should not have served as the lead auditor. These deficiencies were observed in large and small firms, and in domestic and international audits. There also have been inspection



findings in which the lead auditor failed to assess the qualifications of other auditors' personnel who participated in the audit.⁶⁰

These observed deficiencies, whether related to the work of the other auditor or the lead auditor, could have a negative effect on audit quality even if existing requirements related to the lead auditor's use of other auditors are not violated. This could result in potential risks to investors that are difficult for investors to respond to, because the root cause of the deficiencies (*e.g.*, lack of supervision by the lead auditor of the work of other auditors) may be difficult for investors to observe.

The academic literature provides some insight on the impact of using other auditors on overall audit quality.

Relatively few empirical studies have explicitly examined the relationship between the use of other auditors and audit quality, perhaps because of the relative lack of accessible data. Among the available studies, a published paper and a working paper suggest that audits involving other auditors can exhibit lower overall audit quality than audits that do not involve other auditors, although the research does not clearly indicate whether the decrease in overall audit quality was attributable to the lead auditor or to the other auditors.⁶¹ The small number of recent empirical studies, and the particularity of conditions studied, suggest that the impact of using other auditors on overall audit quality is still a largely unanswered empirical question and may depend on the facts and circumstances of the audit.

It is common for audits using other auditors to take place in different locations, including different countries. Academic research on the challenges of this type of work (but not exclusively on auditing) finds that coordination and communication challenges in geographically distributed work may present challenges: (i) when work is conducted by teams distributed across cities, countries or continents,⁶² (ii) when there are

⁶⁰ See Section II.B.2 above.

⁶¹ See Carol Callaway Dee, Ayalew Lulseged, and Tianming Zhang, *Who Did the Audit? Audit Quality and Disclosures of Other Audit Participants in PCAOB Filings*, 90 *The Accounting Review* 1939 (2015) (studying a population of auditors who had not acted as principal auditor for any SEC issuer) (Professor Dee is a former academic fellow and a current consultant at the PCAOB, and her research cited here was undertaken prior to joining the PCAOB); Elizabeth Carson, Roger Simnett, Greg Trompeter, and Ann Vanstraelen, *The Impact of Group Audit Arrangements on Audit Quality and Pricing* (Nov. 2014) (working paper, available in Social Science Research Network ("SSRN")) (based on a study of Australian issuers).

⁶² See, *e.g.*, Denise R. Hanes, *Geographically Distributed Audit Work: Theoretical Considerations and Future Directions*, 32 *Journal of Accounting Literature* 1,

differences in language, culture or regulation⁶³ or (iii) when teamwork is required that involves a number of interdependent activities.⁶⁴

If the cost to the auditor of overcoming these challenges (e.g., through additional supervision of other auditors) exceeds the lead auditor's perception of the benefits of doing so (e.g., in terms of reduced risks of litigation, reputational loss, and regulatory sanction as a result of improving audit quality), then audit quality may suffer.⁶⁵ The impact on audit quality could be especially significant because the lead auditor makes important decisions about how the audit is performed, including whether they perform a sufficient portion of the audit to issue the audit report.

Question:

4. The Board requests comment generally on the baseline for evaluating the potential economic impacts of the proposal. Are there additional academic studies or data the Board should consider? The Board is particularly interested in studies or data that could be used to assess potential benefits and costs.

B. Need for the Proposal

Audit quality is important to investors because audit quality is a component of financial reporting quality, in that high audit quality increases the credibility of financial statements. Conversely, lower audit quality can create uncertainty about the reliability of

5–7 (2013), for an inter-disciplinary survey of related academic research on challenges in coordinating and managing geographically distributed work.

⁶³ See *id.* (observing that communication and coordination can be impaired by differences in time, language, and cultural factors that impair the formation of shared norms and understanding across locations).

⁶⁴ See, e.g., Kannan Srikanth and Phanish Puranam, *Integrating Distributed Work: Comparing Task Design, Communication, and Tacit Coordination Mechanisms*, 32 Strategic Management Journal 849, 849, 850 (2011) ("We find that interdependence [between different locations] can lower ... performance [at one of the locations]."; "In general, more complex forms of interdependence require greater efforts to achieve coordination.").

⁶⁵ See note 61 above.



the company's financial statements and lead investors to require a greater risk premium to invest in securities.⁶⁶

The observed deficiencies in audits that involve other auditors described above may be explained by economic theory. In audits involving other auditors, a market failure⁶⁷ is caused, at least in part, by the information asymmetry⁶⁸ that exists between investors and the lead auditor regarding the lead auditor's effort in supervising other auditors – investors are uncertain what procedures are 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.

Because of this information asymmetry, the lead auditor may not be adequately motivated to (i) gather information about the competence of, and work performed by, the other auditor, or (ii) monitor and review (*i.e.*, supervise) the other auditor's work, leading to a moral hazard problem.⁶⁹ For example, cost considerations may provide a

⁶⁶ See Turan G. Bali and Hao Zhou, *Risk, Uncertainty, and Expected Returns* (Aug. 2014) (working paper, available at SSRN); and Evan W. Anderson, Eric Ghysels, and Jennifer L. Juergens, *The Impact of Risk and Uncertainty on Expected Returns* 94 *Journal of Financial Economics* 233 (2009).

⁶⁷ "Market failure" refers to a situation in which markets fail to function well. What is considered to be a well-functioning market can involve value judgments. One can distinguish between complete and partial market failure: Complete market failure occurs when a market simply does not operate at all, because there are either no willing buyers (but many willing producers) or no willing producers (but many willing buyers). Partial market failure occurs when a market does function but produces either the wrong quantity of a product, or produces a product at the wrong price, or produces products at the wrong level of quality. For example, a market for public company audits which consistently produces deficient audits would be considered a market experiencing partial market failure. See, *e.g.*, Francis M. Bator, *The Anatomy of Market Failure*, 72 *The Quarterly Journal of Economics*, 351 (1958); Steven G. Medema, *The Hesitant Hand: Mill, Sidgwick, and the Evolution of the Theory of Market Failure*, 39 *History of Political Economy* 331 (2007).

⁶⁸ "Information asymmetry" may exist in financial markets when there is a separation of ownership (investors) and control (management), because this separation gives company management an informational advantage over investors. Likewise, information asymmetry exists between auditors and investors because the auditor knows his or her own audit quality, which is not observable by the investor.

⁶⁹ The term "moral hazard" does not refer to a person's morality, but rather to the incentive an agent may have to take actions that benefit the agent at the expense of harming the principal. Agents with a moral hazard problem may, for example, "shirk"

disincentive to the lead auditor to adequately supervise other auditors.⁷⁰ For some auditors, the cost considerations may outweigh an auditor's general incentive to mitigate risks arising from using other auditors. Similarly, moral hazard may occur if the lead auditor inadequately scrutinizes the quality of the other auditor's work or judgment⁷¹ and fails to see reasons to perform additional supervisory procedures.⁷²

Adequate supervision of other auditors by the lead auditor is important because the other auditor is likely to have better information (compared to the lead auditor) about its effort and the quality of its work. In the absence of adequate supervision, the other auditor may avoid costly procedures if the other auditor believes the negative consequences of performing low quality audit work, which include the risks of litigation, reputational loss, or regulatory sanction, are comparatively minor.

Strengthening the performance requirements for lead auditors can augment the lead auditor's incentive to monitor the performance of the other auditor through adequate supervision of the other auditor's work. The strengthening of performance requirements could increase the consistency of auditor performance and improve audit quality overall. The proposed amendments to auditing standards are designed to improve audit quality and provide more specificity to investors about the nature and scope of work required to be performed by the lead auditor when using other auditors.⁷³

and not work hard enough on behalf of the principal's interests. See, e.g., Bengt Holmstrom, *Moral Hazard and Observability*, 10 *Bell Journal of Economics*, 74 (1979).

⁷⁰ The general effect of cost pressures on audit quality has been studied in the academic literature with varying empirical findings. See, e.g., James L. Bierstaker and Arnold Wright, *The Effects of Fee Pressure and Partner Pressure on Audit Planning Decisions*, 18 *Advances in Accounting* 25 (2001); B. Pierce and B. Sweeney, *Cost-Quality Conflict in Audit Firms: An Empirical Investigation*, 13 *European Accounting Review* 415 (2004).

⁷¹ See, e.g., Jun Han, Karim Jamal, and Hun-Tong Tan, *Auditors' Overconfidence in Predicting the Technical Knowledge of Superiors and Subordinates*, 30 *Auditing: A Journal of Practice & Theory* 1 (2011).

⁷² Quality control deficiencies in GNFs may contribute to the problems caused by information asymmetry between the lead auditor and other auditors, since it is common for other auditors to be selected by lead auditors based on network affiliation rather than other factors relevant to audit quality.

⁷³ The audit provides investors with a credence service. Credence services (or goods) are difficult for consumers to value because their benefits are difficult to observe and measure. Because the seller of the product knows the value of the credence service, information asymmetry between the buyer and seller of the service

Question:

5. The Board requests comment generally on the analysis of the need for the proposal. The Board is interested in any alternative economic approaches to analyzing the issues presented in this release, including references to relevant data, studies, or academic literature.

C. Economic Impacts

The proposal aims to clarify and strengthen the lead auditor's supervisory requirements to provide lead auditors with better direction and a stronger incentive to more consistently produce high quality audits when using other auditors.⁷⁴ Everything

can arise. See Monika Causholli and W. Robert Knechel, *An Examination of the Credence Attributes of an Audit*, 26 Accounting Horizons 631 (2012). See also Alice Belcher, *Audit Quality and the Market for Audits: An Analysis of Recent UK Regulatory Policies*, 18 Bond Law Review 1, 5 (2006) (An "audit is a credence service in that its quality may never be discovered by the company, the shareholders or other users of the financial statements. It may only come into question if a 'clean' audit report is followed by the collapse of the company.").

⁷⁴ This proposal and another PCAOB rulemaking (which the Board has adopted) would mitigate different aspects of investors' uncertainty about audits involving other auditors. The current proposal would mitigate investors' uncertainty about audit quality by increasing the requirements for supervising other auditors. In the other rulemaking, the Board adopted new rules and related amendments to auditing standards to require accounting firms to disclose, in audits of issuers, (i) the name of the audit engagement partner, (ii) the name, location, and extent of participation of each other accounting firm participating in the audit whose work constituted at least 5 percent of total audit hours, and (iii) the number and aggregate extent of participation of all other accounting firms participating in the audit whose individual participation was less than 5 percent of total audit hours. 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). The final rules adopted by the Board in that rulemaking were intended to improve the transparency and accountability of issuer audits by adding to the mix of information available to investors. The Board also acknowledged that disclosure of accounting firm participation could allow financial statement users to understand how much of the audit was performed by the firm issuing the audit report and how much was performed by other accounting firms, including those in jurisdictions where the PCAOB has been unable to conduct inspections. See *id.* at 5.

else being equal, the magnitude of the benefits and costs of the proposed amendments are likely to be affected by the nature of the work and the risks involved in the work performed by other auditors, because more complex work and work in areas of greater risk will likely require greater supervisory efforts by the lead auditor. In addition, benefits and costs are likely to be affected by the degree to which accounting firms have already adopted audit practices that are similar to those the proposed amendments would require. For example:

- The proposal would likely have the greatest impact – providing the greatest benefits and imposing the highest costs – on audits using methodologies based on AS 1205 where the lead auditor has a relatively low level of involvement in the work of the other auditor (as described in Section IV.A.3(i) above). These audits may be performed more often by small firms or firms that infrequently conduct audits that involve other auditors.
- The proposal would likely have a more moderate impact – providing fewer benefits and imposing fewer costs – for audits in which the lead auditor currently applies an approach that requires greater involvement in the work of the other auditor than required by AS 1205 (as described in Section IV.A.3(ii) above) but less than what is being proposed. These audits are typically performed by firms whose methodologies are based primarily on international standards and include certain further procedures for audits under PCAOB standards.
- The proposal would likely have the least impact – providing the fewest benefits and imposing the fewest costs – on audits currently performed by firms that have made changes to their methodologies to require supervisory procedures that go beyond the requirements of AS 1205 and international auditing standards and generally require a higher level of involvement in the work of the other auditor (as described in Section IV.A.3(iii) above). The audits performed by some U.S. GNFs are more likely to fall into this category.

The remainder of this section discusses the potential benefits, costs, and unintended consequences that may result from the amendments the Board is proposing.

1. Benefits

The proposal would benefit investors and the public by mitigating the causes of market failure, as discussed above in Section IV.B. The proposal, which is informed by

the issues observed in practice through PCAOB inspection and enforcement activities, would have the following impacts:

- The proposal would increase the accountability of the lead auditor by superseding AS 1205 and amending AS 2101 and AS 1201 to apply in all situations in which the lead auditor involves other auditors. The proposed amendments would include additional requirements to provide the lead auditor with more specificity and clarity about the lead auditor's supervisory responsibilities. The proposed amendments to AS 2101 and AS 1201 would take into account changes in practices and would include incremental enhancements to address audit deficiencies of other auditors that continue to occur in practice.
- The proposal would require a more uniform, risk-based approach to the lead auditor's supervision of other auditors, which should increase the quality of the lead auditor's performance. Currently, lead auditors can apply a range of different approaches for using other auditors without transparency to investors. Under the proposal, lead auditors would supervise other auditors under the amended AS 1201 when they assume responsibility for the other auditors' work. Investors would form expectations of audit quality under the more standardized and improved supervisory framework, and thus have greater certainty about the lead auditor's approach to supervision and the quality of the audit.⁷⁵

More specifically, the proposal would require the lead auditor to determine sufficiency of its participation in the audit based on risk, and be better informed about the qualifications and performance of the other auditor. Proposed amendments to AS 2101, for example, would:

- Require the engagement partner to determine whether the participation of his or her firm is sufficient for the firm to serve as lead auditor, taking into account the risks of material misstatement;

⁷⁵ Academic research indicates that perceived changes in audit quality can change investor behavior, including in response to changes in auditor incentives related to regulatory changes. See, e.g., Jason L. Smith, *Investors' Perceptions of Audit Quality: Effects of Regulatory Change*, 31 *Auditing: A Journal of Practice & Theory* 17 (2012) (finding, in an experiment using MBA students as proxies for investors, that a perceived reduction in audit quality due to regulatory changes resulted in a reduction in equity investment, as investors reacted negatively to the adverse effect of the regulatory changes on auditor incentives to provide audit quality).



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- Require the lead auditor to have discussions with other auditors to be informed about potential risks of material misstatement; and
- Require the lead auditor to become appropriately informed about the following regarding the other auditor in determining its extent of supervision: (i) the other auditor's understanding of, and compliance with, pertinent independence and ethics requirements, and compliance with registration requirements; (ii) the other auditor's qualifications with respect to the scope of work to be performed; and (iii) the lead auditor's ability to communicate with the other auditor(s) and gain access to their work papers.

The proposal would also increase the requirements for the lead auditor to monitor and review (*i.e.*, supervise) the work of other auditors. For example, proposed amendments to AS 1201 would require the lead auditor to:

- Provide the other auditor(s) with specific information in writing;
- Obtain and review the other auditor's description of audit procedures it plans to perform;
- Obtain, review, determine, and communicate in writing whether changes to the other auditor's description of audit procedures to be performed are necessary; and
- Determine, based on a review of the other auditor's documentation and written report, information obtained from discussions with the other auditor, and other information obtained during the audit, whether the other auditor complied with the written communications received from the lead auditor and whether additional audit evidence should be obtained by the other auditor.⁷⁶

By improving the requirements for the lead auditor's supervision of other auditors, the proposal aims to increase the likelihood that auditors detect material misstatements in the financial statements.

Investors also may benefit from the proposed amendments indirectly. For example, under existing standards, the auditor is required to communicate with the audit

⁷⁶ The proposed amendments for the supervision of other auditors also include provisions, in proposed Appendix B of AS 1201, that are designed to make the provisions of the standard scalable for multi-tiered audits in which an other auditor supervises additional other auditors.



committee its overall audit strategy, significant risks, and results of the audit, including work performed by other auditors, among other things.⁷⁷ Because of the proposed lead auditor's enhanced involvement in the work of other auditors, the quality of communications with audit committees could also be enhanced, specifically as it relates to risks of material misstatements in the financial statements related to the component(s) of the company audited by the other auditor(s). Such enhanced discussions with the audit committee could improve the audit committee's oversight of the audit by highlighting areas where audit committees and companies should increase attention to ensure the quality of their financial statements, including related disclosures. Such increased attention by audit committees and companies could result in higher quality financial reporting, which would benefit investors.

Improving the quality of audits and financial reporting can reduce investors' uncertainty about the information being provided in company financial statements, foster increased public confidence in the financial markets, and enhance capital formation. In particular, improving the quality of the information available to financial markets can increase the efficiency of capital allocation decisions and decrease the cost of capital.⁷⁸

Auditors also may benefit from the proposed requirements, because an increase in audit quality reduces the risk of the auditor's failure to detect material misstatements, and, as a result, the risk of litigation, regulatory sanction or reputational loss faced by auditors could decrease.

The magnitude of these benefits from improved audit quality will likely vary to the extent that current practices reflect the proposed requirements. Based on observations from the Board's oversight activities, most firms would need to enhance their methodologies, but to varying degrees. In general, the greatest changes, and the

⁷⁷ See paragraphs .09–.24 of AS 1301 (currently Auditing Standard No. 16), *Communications with Audit Committees*.

⁷⁸ See, e.g., Michael Welker, *Disclosure Policy, Information Asymmetry, and Liquidity in Equity Markets*, 11 *Contemporary Accounting Research* 801 (1995) (increases in equity markets in response to additional disclosure); Partha Sengupta, *Corporate Disclosure Quality and the Cost of Debt*, 73 *The Accounting Review* 459 (1998); Christine A. Botosan and Marlene A. Plumlee, *A Re-examination of Disclosure Level and the Expected Cost of Equity Capital*, 40 *Journal of Accounting Research* 21, 39 (2002); Richard Lambert, Christian Leuz, and Robert E. Verrecchia, *Accounting Information, Disclosure, and the Cost of Capital*, 45 *Journal of Accounting Research* 385 (2007) (Professor Leuz is an economic advisor to the PCAOB's Center for Economic Analysis); and Richard A. Lambert, Christian Leuz, and Robert E. Verrecchia, *Information Asymmetry, Information Precision, and the Cost of Capital*, 16 *Review of Finance* 1 (2011).

greatest benefits, are likely to occur with lead auditors that need to enhance their methodologies the most.

Question:

6. The Board requests comment generally on the potential benefits to investors and the public. Are there additional benefits the Board should consider?

2. Costs

The Board recognizes that imposing new requirements may result in additional costs to auditors and the companies they audit. Auditors may incur certain fixed costs (costs that are generally independent of the number of audits performed) related to implementing the proposal. These include costs to update audit methodologies and tools, and to prepare training materials and conduct training. Large firms are likely to update methodologies using internal resources, whereas small firms are more likely to purchase updated methodologies from external vendors.⁷⁹

In addition, auditors may incur certain variable costs (costs that are generally dependent on the number of audits performed) related to implementing the proposal. These include costs of implementing the proposal at the audit engagement level. For example, to implement the proposed additional requirements for the lead auditor and the engagement quality reviewer, both lead auditors and other auditors may:

- Increase the number of engagement team members (at the lead auditor firm and other firms) and engagement quality reviewer assistants;
- Increase the amount of time incurred by the existing team members and engagement quality reviewers and their assistants; or
- Incur additional costs traveling to a company's locations or business units at which audit procedures are to be performed.

Finally, to comply with the proposed sufficiency of participation requirements, the lead auditor, in some circumstances, may decrease the share of work performed by other

⁷⁹ For context, PCAOB staff analysis of data for the 2013 and 2014 inspections shows that less than two percent of audits performed by U.S. registered firms not affiliated with one of the GNFs (*i.e.*, non-affiliated firms or NAFs) and about ten percent of audits performed by registered non-U.S. NAFs were engagements involving other auditors.



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auditors and increase the share of its own work. This possible result is discussed in Section IV.C.3 below as a potential unintended consequence of the proposal.

The proposal's impact on the auditor's fixed and variable costs would likely vary depending on, among other things, whether any of the proposed requirements have already been incorporated in accounting firms' audit methodologies or applied in practice by individual engagement teams. As discussed above, for firms that have implemented approaches that require greater lead auditor involvement, the costs of implementing the proposed requirements may be lower than for firms that currently require less lead auditor involvement. In addition, the proposal's impact could vary based on the size and complexity of an audit. All else equal, anticipated costs generally would be higher for larger, more complex audits than for smaller, less complex audits.

The proposal's impact on the auditor's fixed and variable costs could differ for each particular engagement, depending on which audit approach is currently taken and whether that approach would still be permissible under the proposed requirements. For example, in an audit engagement where the work performed by other auditors involves low-risk areas of the audit and is currently performed under AS 1205, the proposal may have little effect on the lead auditor's supervisory efforts because of the scalable nature of the risk-assessment standards, including AS 1201. At the same time, the lead auditor could experience some increases in cost in such an audit engagement due to the proposed communication requirements.

The economic impact of the proposal on larger accounting firms and smaller accounting firms may differ. For example, larger firms and smaller firms may employ different methodologies and approaches, as discussed above in Section IV.A.3. Additionally, larger accounting firms, which often perform audits involving other auditors, would likely take advantage of economies of scale by distributing fixed costs (e.g., updating audit methodologies) over a larger number of audit engagements. Smaller accounting firms, which less often perform audits that involve other auditors, would likely distribute their fixed costs over fewer audit engagements. However, larger accounting firms would likely incur more variable costs due to the proposal than smaller firms would, because larger firms more often perform larger audits and audits involving other auditors. It is not clear whether these costs (fixed and variable), as a percentage of total audit costs, would be greater for larger or for smaller accounting firms.

For audits that involve divided responsibility (in which the lead auditor divides responsibility for the audit with another accounting firm), the anticipated impact of the proposal on the lead auditor's costs is not likely to be significant. Only about 50 audits per year involve divided responsibility, and the proposed changes to PCAOB standards that apply to those scenarios are not as significant as other changes included in the proposal.

In addition, companies being audited may incur costs related to the proposed amendments, both directly and indirectly. Companies, including audit committees and financial statement preparers, could incur direct costs from engaging with or otherwise supporting the auditor performing the audit. For example, some companies could face costs of producing documents and responding to additional auditor requests for audit evidence, due to more rigorous evaluation of audit evidence by lead auditors. Companies may incur additional costs if audit committees need to discuss with the auditor additional information provided as a result of the proposal. To the extent that auditors incur higher costs to implement proposed requirements and are able to pass on at least part of the increased costs through an increase in audit fees, companies could incur an indirect cost.⁸⁰

Question:

7. The Board requests comment generally on the potential costs to auditors and companies they audit. Are there additional costs the Board should consider?

3. Unintended Consequences

In addition to the benefits and costs discussed above, the proposed amendments could have unintended economic impacts. The following discussion describes potential unintended consequences considered by the Board and steps the Board has taken to mitigate the negative consequences.

First, unlike AS 1205 (which would be superseded by the proposal), AS 1201 does not contain a statement that "the other auditor remains responsible for the performance of his own work and for his own report." Thus, it is possible that the other auditor could feel less accountable given that the proposal focuses the responsibility for providing direction and supervision of the other auditor on the lead auditor. If this occurred, audit quality could decrease. To mitigate this potential consequence, the proposal includes a requirement that the lead auditor obtain from the other auditor a

⁸⁰ It is not clear to what extent the increased auditor performance requirements would result in increased audit fees. The Board is aware of public reports that have analyzed historical and aggregate data on audit fees and which suggest that audit fees generally have remained stable in recent years, notwithstanding the fact that the Board and other auditing standard setters have issued new standards during that period. See, e.g., Audit Analytics, *Audit Fees and Non-Audit Fees: A Thirteen Year Trend* (Aug. 2015). Because amendments to, and adoption of, new Board standards typically involve discrete parts of an audit, which are not accounted for or priced on a standard-by-standard basis, it is difficult to obtain data that isolate the costs of particular new audit standards and that would be comparable between firms.



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written report describing the other auditor's procedures, findings, conclusions, and if applicable, opinion. Notably, under the proposal, the other auditor would continue to remain responsible for, among other things, obtaining sufficient appropriate audit evidence to support its written report describing the other auditor's procedures, findings, conclusions, and if applicable, opinion. In addition, the other auditor's work would be subject to the heightened supervision of the lead auditor under the amended standards, which would reduce the other auditor's opportunities for performing inferior work without detection. Finally, the other auditor's work would continue to be subject to PCAOB oversight activities if they are a registered firm.

Second, because lead auditor personnel would be required to perform additional supervisory responsibilities, such team members might have less time to perform other work on the same engagement. This could potentially reduce the likelihood that the auditor detects material misstatements in the portion of the financial statements for which the lead auditor performs procedures and could potentially lead to inefficient allocation of audit resources. The proposal intends to mitigate this possible unintended consequence by proposing risk-based supervision requirements. Under the proposal, the additional supervisory procedures would be required for the work performed by the other auditor to provide the lead auditor with a basis for concluding whether the financial statements are free of material misstatement. Thus, under the proposal, the lead auditor would focus its efforts on audit areas with the greatest risk of material misstatement to the financial statements. This should result in an appropriate focus on the riskiest audit areas, whether those areas are audited by the lead auditor directly or by another auditor under the lead auditor's supervision.

Third, in response to (i) the potential costs or any practical difficulties of supervising other auditors under the proposed amendments or (ii) the proposed sufficiency of participation requirements, the lead auditor, in some circumstances, may decrease the share of work performed by other auditors and increase the share of its own work. To the extent the other auditors possess knowledge of important country-specific information, limiting their involvement in the engagement may negatively impact audit quality. This potential outcome, however, would be contrary to the following existing PCAOB standards:

- "Auditors 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";⁸¹

⁸¹ Paragraph .06 of AS 1015 (currently AU sec. 230), *Due Professional Care in the Performance of Work*.

- "The knowledge, skill, and ability of engagement team members with significant engagement responsibilities should be commensurate with the assessed risks of material misstatement";⁸² and
- Firms are required to have policies and procedures in place that provide reasonable assurance that the firm will undertake only those engagements that the firm can reasonably expect to be completed with professional competence.⁸³

In addition, legal restrictions in some countries that prohibit a foreign auditor from providing professional services in the country could limit a foreign lead auditor's ability to take on more work and assign less work to the other auditor in the country.

Fourth, some auditors who currently use the other auditor's work under AS 1205 may view compliance with the proposed supervision under AS 1201 as too costly and decide instead to divide responsibility for the audit with the other auditor. There are limited research findings available regarding the division of responsibility,⁸⁴ and it is not clear whether an increase in audits with divided responsibility would adversely affect audit quality. In order to provide transparency about such situations, however, the proposal would require that, in a divided-responsibility scenario, the lead auditor disclose in its audit report: (i) that part of the audit is performed by another accounting firm; (ii) the magnitude of the portion of the company's financial statements audited by the referred-to auditor; and (iii) the referred-to auditor's name.⁸⁵

⁸² Paragraph .05a of AS 2301 (currently Auditing Standard No. 13), *The Auditor's Responses to the Risks of Material Misstatement*.

⁸³ Paragraph .15 of QC sec. 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*.

⁸⁴ One academic study indicates that financial statements with audit reports containing explanatory language (including, among others, the division of responsibility disclosure) were more likely to be subsequently restated than financial statements without such language. See Keith Czerney, Jaime J. Schmidt, and Anne M. Thompson, *Does Auditor Explanatory Language in Unqualified Audit Reports Indicate Increased Financial Misstatement Risk?*, 89 *The Accounting Review* 2115 (2014).

⁸⁵ SEC Regulation S-X also currently requires that, in divided responsibility scenarios, the other auditor's report be filed with the SEC. See Regulation S-X Rule 2-05 ("If, with respect to the examination of the financial statements, part of the examination is made by an independent accountant other than the principal accountant and the principal accountant elects to place reliance on the work of the other accountant and makes reference to that effect in his report, the separate report of the other accountant shall be filed.").



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Fifth, because the proposal would require performing additional supervisory procedures, it could unintentionally decrease competition in the audit market because smaller firms, which lack economies of scale, may be less able to compete with larger firms in the market for audits that require or would benefit from the involvement of other auditors. This is most likely to occur in the segment of the audit market serving larger and more complex companies since this is the segment more likely to involve decentralized operations or subsidiaries. However, it is the Board's understanding, based on PCAOB oversight activities, that smaller firms already perform relatively fewer audits that involve other auditors than larger firms. Thus, any impact on competition in the overall audit market is likely to be relatively small.

Finally, it might be possible that some audits currently conducted under AS 1205 would not benefit from the additional supervisory requirements being proposed. This situation could occur, for example, on very simple low-risk audits that involve highly qualified other auditors. A potential unintended consequence of the proposal would be that the lead auditor could incur additional costs to comply with the additional proposed supervisory requirements without yielding a corresponding benefit. This inefficient outcome is mitigated by the risk-based and scalable aspects of the proposed requirements, which rely on the lead auditor to make judgments about the nature and extent of supervision of other auditors based on risks.

Questions:

8. The Board requests comment generally on the potential unintended consequences of the proposal. Are the responses to the potential unintended consequences discussed in the release adequate? Are there additional potential unintended consequences that the Board should consider? If so, what responses should be considered?
9. Could the proposed requirement for lead auditor supervision diminish (or be perceived as diminishing) the other auditor's accountability for the work the other auditor performs? If so, are any changes to the proposal needed to describe the other auditor's responsibilities?
10. Could the proposed requirement for lead auditor supervision induce lead auditors in some audits to divide responsibility with another accounting firm rather than supervise the accounting firm? If so, how often might this division of responsibility occur?

D. Alternatives Considered

The development of the proposal involved considering a number of alternative approaches to address the problems described above. This section explains: (i) why

standard-setting is preferable to other policy-making approaches, such as providing interpretive guidance or enhancing inspection or enforcement efforts; (ii) other standard-setting approaches that were considered; and (iii) key policy choices made by the Board in determining the details of the proposed standard-setting approach.

1. *Why Standard-Setting Is Preferable to Other Policy-Making Approaches*

The Board's policy tools include alternatives to revising the standard setting, such as issuing additional interpretive guidance or an increased focus on inspections or enforcement of existing standards. The Board considered whether providing guidance or increasing inspection or enforcement effort would be effective corrective mechanisms to address concerns with the supervision of other auditors and the sources of market failure discussed in Section IV.B. The Board concluded that interpretive guidance, inspections, or enforcement actions alone would be less effective in achieving the Board's objectives than in combination with amending auditing standards. Interpretive guidance inherently provides additional information about existing standards. Inspection and enforcement actions take place after insufficient audit performance (and potential investor harm) has occurred. Devoting additional resources to guidance, inspections, and enforcement activities without improving the relevant performance requirements for auditors would, at best, focus auditors' performance on existing standards and would not gain the benefits associated with improving the standards. The Board's approach reflects its conclusion that standard setting is needed to fully achieve the benefits resulting from improvement in audits involving multiple auditors.

2. *Other Standard-Setting Alternatives Considered*

The Board considered certain standard-setting approaches, including: (i) retaining the existing framework but requiring the lead auditor to disclose which supervisory standard (AS 1201 or AS 1205) was used to oversee the work of other auditors; (ii) amending AS 1205 or extending the approach in AS 1205 to cover all arrangements involving other auditors; (iii) developing a new standard, in addition to the Board's risk assessment standards, that would address all arrangements with other auditors; or (iv) the proposed approach which comprises amending AS 1201, and describing the requirements for the divided-responsibility audits in a new proposed standard AS 1206.

(i) *Disclosing Which Standard Applies Under Existing Framework*

The Board considered but is not proposing a requirement that the lead auditor disclose, in the audit report or elsewhere, whether the lead auditor applied AS 1205 or AS 1201 to its use of the other auditor. A disclosure approach would not achieve the



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benefits of applying AS 1201 (as amended by the Board's proposal) to all audits that involve other auditors, and inconsistencies between firms in their approaches to the oversight of other auditors would remain.⁸⁶

From an economic perspective, it would be more efficient and effective to address the reasons for change described above in this release by amending existing auditing standards on supervision than by disclosing which standard applies. The proposed amendments would directly address the lead auditor's incentives, whereas disclosing which standard applies would do so indirectly at best. For disclosure to sufficiently change the lead auditor's incentives, investors would need to apply significant market pressure on auditors to improve their supervisory procedures beyond current requirements. This approach seems unlikely given the wide dispersion of share ownership among investors and the costs of engaging in collective action.

(ii) Amending AS 1205

The Board considered, but is not proposing, two alternative approaches that would amend rather than supersede AS 1205. The first approach would have amended AS 1205 to strengthen its supervisory requirements but otherwise retain the existing two-standard framework in which an engagement involving other auditors could be governed by either AS 1205 or AS 1201. The second approach would have amended AS 1205 to extend its application to all arrangements involving other auditors such that AS 1201 would no longer apply.

The Board determined that the risk-based supervision approach in AS 1201 promotes a more appropriate involvement by the lead auditor than the approach in AS 1205. The supervisory approach in AS 1201 requires that the level of supervision be commensurate with the associated risks, and that would apply to supervision of the other auditors' work. From an economic perspective, the risk-based approach, which is now a well-established and understood auditing practice, requires the auditor to take into account the facts and circumstances of an audit engagement to inform a variety of resource allocation decisions, including the nature, timing, and extent of its supervision of other auditors. This approach enables the lead auditor to better align its supervisory effort with the riskiest areas of the audit and thus provide more risk mitigation benefit to investors. Similarly, the other auditor's communication of important and relevant information to the lead auditor allows the lead auditor to make better-informed decisions regarding the work of the other auditor.

⁸⁶ In a separate rulemaking, the Board has adopted rules and amendments to its auditing standards to require that the auditor, among other things, disclose information about other accounting firms that participated in the audit. See note 74 above.



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In contrast, AS 1205 employs an approach that allows the lead auditor to use the work of other auditors based on the performance of certain limited procedures that are not explicitly required to be tailored for the associated risks. Thus, the approach of AS 1205 would not address the problems described in this release as effectively as the supervisory approach of AS 1201 would.

(iii) *Developing a New Standard for All Arrangements with Other Auditors*

The Board also considered developing a new, separate standard to govern all arrangements with other auditors. Although the IAASB and ASB adopted new standards for group audits, ISA 600 and AU-C Section 600, the Board believes that proposing a separate standard is not necessary for the vast majority of audits involving other auditors in which the lead auditor uses the other auditors' work. (The proposal would describe requirements for divided-responsibility audits in a separate standard, AS 1206.) The risk-based standard on supervision is already applicable to some audits involving other auditors, appropriately scalable, familiar to auditors, and integrated with the Board's other risk assessment standards. Accordingly, the proposed approach involves a less drastic approach of enhancing the existing standard through targeted amendments imposing certain requirements on the lead auditor, rather than creating an entirely new standard.

(iv) *Amending to Address Oversight of Multi-location Engagements*

The Board considered, but is not proposing, amendments to existing standards that would apply to oversight of multi-location audit engagements generally (including multi-location engagements performed by a single firm), in addition to amendments that apply to the auditor's use of other auditors. The Board is not proposing such amendments because other PCAOB auditing standards already specifically address multi-location engagements.⁸⁷ Additional requirements for these audits, along with

⁸⁷ Requirements for multi-location engagements are specifically addressed in risk assessment standards adopted by the Board in 2010. See, e.g., AS 2101 (currently Auditing Standard No. 9), *Audit Planning*; AS 2105 (currently Auditing Standard No. 11), *Consideration of Materiality in Planning and Performing an Audit*; AS 2110 (currently Auditing Standard No. 12), *Identifying and Assessing Risks of Material Misstatement*; AS 2301 (currently Auditing Standard No. 13), *The Auditor's Responses to the Risks of Material Misstatement*. See also AS 2401 (currently AU sec. 316), *Consideration of Fraud in a Financial Statement Audit*; AS 1215 (currently Auditing Standard No. 3), *Audit Documentation* (Basis for Conclusions paragraphs A60 – A67); AS 6115 (currently Auditing Standard No. 4), *Reporting on Whether a Previously Reported Material Weaknesses Continues to Exist*.



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requirements for supervising other auditors, could create unnecessary complexity and redundancy with existing requirements. Finally, greater concerns have arisen through the Board's oversight observations of audits involving other auditors than of single-firm multi-location engagements.

3. Key Policy Choices

Given a preference for amending AS 1201, the Board considered different approaches to addressing key policy issues.

(i) Sufficiency of the Lead Auditor's Participation

To increase the likelihood that a lead auditor performs audit procedures for a meaningful portion of the financial statements based on risk, the Board's proposing to require that the lead auditor determine the sufficiency of its participation in all audits that involve other auditors. Sufficient participation by the lead auditor is important because it helps the firm issuing the audit report to obtain sufficient appropriate evidence in the highest risk areas of the audit. In evaluating the alternative approaches, the Board weighed the practical implications of specific criteria or conditions on the efficiency and effectiveness of the audit. The Board also evaluated, among other things, relevant information from its oversight activities and views from its SAG members.⁸⁸

The proposed requirement for determining sufficiency of participation would be based on the risks of material misstatement associated with the portion of the financial statements audited by the firm, which includes considering the portion's materiality, in comparison with the portions for which the other auditors perform audit procedures or the portions audited by the referred-to auditors. Ordinarily, the lead auditor would need to audit the location at which the primary financial reporting decisions were made and the consolidated financial statements were prepared in order to address the risks related to those important judgments and activities, and a sufficient number of locations to cover a greater portion of the risks than any of the other audit firms performing procedures on the audit. Under this proposed approach, the criterion for the determining sufficiency of participation would be aligned with the principle for determining the scope of work in a multi-location audit, as both would be based on the risk associated with the respective locations or business units.

The Board considered, but is not proposing, a requirement based on a quantitative threshold, such as the number of material locations or percentage of assets or operations to be audited by the lead auditor. A determination of sufficiency based on quantitative thresholds would impose constraints that could limit the effectiveness and efficiency of the audit. For example, if a threshold were too high, in an audit of a

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See note 46 above.



company with highly dispersed international operations conducted by multiple firms, none of the firms participating in the audit could serve as the lead auditor. Instead, the proposal uses a risk-based criterion that considers materiality as well as other relevant factors.

Under the proposed risk-based criterion for determining sufficiency of participation, the lead auditor ordinarily would need to audit the location at which the primary financial reporting decisions were made and the consolidated financial statements were prepared in order to address the risks related to those important judgments and activities. The Board considered, but is not proposing, prescribing additional criteria for determining sufficiency of participation based on the location of the company's principal assets, principal operations, and corporate offices. Such additional criteria were not proposed because the risk-based criterion in the proposed amendments already encompasses the consideration of those factors to the extent they pose risks of material misstatement to be addressed in the audit.

(ii) *Lead Auditor's Supervisory Requirements*

When other auditors are involved in an audit, the Board considered whether the lead auditor (which includes the engagement partner and other supervisory personnel of the firm issuing the audit report) should be specifically required to perform certain supervisory procedures, and what the scope of any such procedures should be. Currently, PCAOB standards allow the engagement partner to seek assistance from appropriate engagement team members in fulfilling his or her supervisory responsibilities, but the standards for supervision do not specify which supervisory procedures must be performed by the lead auditor.

In many audits, engagement partners seek assistance in fulfilling their supervisory responsibilities from engagement team members at other accounting firms that participate in the audit. By increasing the lead auditor's monitoring responsibilities, the proposed supervisory procedures for the lead auditor could 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. Thus, these proposed requirements aim to change auditor behavior by strengthening the incentives of the lead auditor, thus addressing the moral hazard problem discussed above.

The Board considered, but is not proposing, requiring that the lead auditor gain an understanding of the qualifications of all engagement team members outside the lead auditor's firm. Instead the proposal would require the lead auditor to gain an understanding of the knowledge, skill, and ability of the other auditors who assist the engagement partner with supervision. The proposed requirement should result in a more effective allocation of audit resources by focusing the lead auditor's efforts on the engagement team members outside the firm with whom the lead auditor primarily



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communicates and who are responsible for supervising the work performed by other engagement team members.

The Board also considered, but is not proposing, requiring the lead auditor to determine the nature, timing, and extent of audit procedures to be performed by the other auditors. Instead, the proposal would require that the lead auditor determine the scope of the work of other auditors and review the other auditor's description of nature, timing, and extent of audit procedures. The proposal also would require the lead auditor determine whether there are any changes necessary to the procedures and communicate them to the other auditors. The proposed approach would be more effective as the lead auditor generally has better visibility of the entire audit and the other auditors have more detailed information than the lead auditor about audit areas in which they are involved.

Questions:

11. The Board requests comment generally on the alternative approaches that the Board considered but is not proposing, as described in this release. Are any of these approaches, or any other approaches, preferable to the approaches the Board is proposing? What reasons support those approaches over the approaches the Board is proposing?
12. Are there additional economic considerations associated with this proposal that the Board should consider? If so, what are those considerations?

V. Considerations for Audits of Emerging Growth Companies

The proposed amendments would apply to audits of issuers, as defined in Section 2(a)(7) of Sarbanes-Oxley. As discussed below, the PCAOB is seeking comment on whether the proposed amendments should apply to audits of emerging growth companies ("EGCs"), as defined in Section (3)(a)(80) of the Securities and Exchange Act of 1934 ("Exchange Act").

Pursuant to Section 104 of the Jumpstart Our Business Startups ("JOBS") Act, any rules adopted by the Board subsequent to April 5, 2012, do not apply to the audits of EGCs 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."⁸⁹ As a result of the JOBS Act, the rules and related amendments to

⁸⁹ See Pub. L. No. 112-106 (Apr. 5, 2012). See Section 103(a)(3)(C) of Sarbanes-Oxley (15 U.S.C. 7213(a)(3)), as added by Section 104 of the JOBS Act.



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PCAOB standards the Board adopts are subject to a separate determination by the SEC regarding their applicability to audits of EGCs.

The data presented in Appendix 5 indicate that, among other things, a majority of EGCs are smaller public companies that are relatively new to the SEC reporting process. This indicates that there is less information available to investors regarding such companies relative to the broader population of public companies. Academic research indicates that, on average, investors are less informed about companies that are smaller and that these companies are followed by fewer analysts.⁹⁰ To the extent that EGCs exhibit one or more of these properties, investors are likely to have less information available about EGCs relative to the broader population of public companies. Accordingly, EGCs are likely to have a greater relative degree of information asymmetry between management and investors.

When confronted with information asymmetry, investors may require a larger risk premium, and thus increase the cost of capital to companies.⁹¹ Reducing information asymmetry, therefore, can lower the cost of capital to companies, including EGCs, by decreasing the risk premium required by investors.⁹²

To benefit from reducing information asymmetry, smaller public companies, including EGCs, must also consider the cost of informing investors. As noted earlier, larger auditors may be able to implement the proposed requirements more cost-effectively than smaller auditors due to greater economies of scale in implementing the new requirements. Thus, audit fees for public companies of any size audited by larger accounting firms may, all else equal, increase to a lesser extent proportionally than audit fees for public companies audited by smaller accounting firms.

Compared to the broader population of public companies with operations outside the country of their lead auditor (*i.e.*, foreign operations), EGCs – a majority of which are smaller companies – are significantly less likely to operate in multiple countries.⁹³ To the

⁹⁰ See, *e.g.*, V. V. Chari, Ravi Jagannathan, and Aharon R. Ofer, *Seasonalities in Security Returns: The Case of Earnings Announcements*, 21 *Journal of Financial Economics* 101 (1988); Michael J. Brennan and Avanidhar Subrahmanyam, *Investment Analysis and Price Formation in Securities Markets*, 38 *Journal of Financial Economics* 361 (1995).

⁹¹ See note 66 above and accompanying text.

⁹² 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).

⁹³ See Appendix 5, section *Geographic Segment Reporting*.

extent that audits of EGCs with foreign operations involve other auditors, the proposed requirements for such audits are likely to affect a smaller proportion of EGCs than the broader population of public companies. This also means that EGCs generally are less likely to incur costs or experience benefits from the proposal as much as the broader population of public companies. However, for EGCs with foreign operations, the percentage of sales and assets outside the country of the lead auditor is significantly higher than for the broader population of public companies with foreign operations.⁹⁴ All else being equal, these EGCs are more likely to incur costs or experience benefits from the proposal as much as, or to a greater extent than, the broader population of public companies.

For those small companies (including EGCs) that are affected, even a small increase in audit fees could negatively affect their profitability and competitiveness. Depending on the magnitude of the cost increase relative to the profitability of the company and the capital formed by investors, the additional audit-related costs could deter companies, in certain circumstances, from entering public markets if those costs weigh on their potential profitability. The increase in costs also could encourage public companies to deregister their securities for the same reasons, as regulatory costs may be determinants of a company's choice to exit public markets if the perceived benefits from reduced costs of capital do not outweigh the costs borne due to regulation.⁹⁵

Question:

13. The Board requests comment generally on the analysis of the impacts of the proposal on EGCs. Are there reasons why the proposal should not apply to audits of EGCs? If so, what changes should be made so that the proposal would be appropriate for audits of EGCs? What impact would the proposal likely have on EGCs, and how would this affect efficiency, competition, and capital formation?

VI. Applicability of the Proposed Requirements to Audits of Brokers and Dealers

The proposed amendments would apply to audits of brokers and dealers, as defined in Sections 110(3)-(4) of Sarbanes Oxley. As discussed below, the PCAOB is seeking comment on whether the proposed amendments should apply to audits of brokers and dealers.

⁹⁴ *Id.*

⁹⁵ See, e.g., Christian Leuz, Alexander Triantis, and Tracy Yue Wang, *Why Do Firms Go Dark? Causes and Economic Consequences of Voluntary SEC Deregistrations*, 45 *Journal of Accounting & Economics* 181 (2008).



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Section 982 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") provided the Board with oversight authority with respect to audits of brokers and dealers that are registered with the SEC. In light of the authority granted to the Board by the Dodd-Frank Act, the SEC adopted on July 30, 2013, amendments to Rule 17a-5 under the Exchange Act to require, among other things, that audits of brokers' and dealers' financial statements be performed in accordance with the standards of the PCAOB for fiscal years ending on or after June 1, 2014. Thus, the auditing standards currently governing the use of other auditors in audits of brokers and dealers are the same as those for audits of issuers. The Board is considering whether the proposed requirements should apply to audits of brokers and dealers.

Information obtained by the Board's staff indicates there are no brokers or dealers that are currently issuers, although some of the largest brokers and dealers are subsidiaries of issuers. Preliminary information from PCAOB inspections indicates that other auditors are used infrequently in audits of brokers and dealers. The small portion of audits of brokers and dealers that involve other auditors generally are also performed in conjunction with audits of the issuer parent. The Board seeks feedback from the public on these observations regarding the use of other auditors in audits of brokers and dealers.

For brokers and dealers that are issuer subsidiaries, the discussion of the need for the proposal and related economic considerations in Section IV generally apply. The rest of this section discusses the economic considerations associated primarily with brokers and dealers that are not issuer subsidiaries.

The brokers and dealers that are not issuer subsidiaries are typically owned by an individual or non-issuer entity that holds a controlling interest. Thus, the owners of brokers and dealers are closely related to the management of the entity, and have direct access to management and the auditor. In those situations, the market failure addressed by the audit of brokers and dealers is distinct from the market failure addressed by the audit of public companies (issuers). While in both cases audits are intended to mitigate problems related to information asymmetry, the parties with whom information asymmetries exist differ. In the case of public company audits, the audit is intended to mitigate the problems related to the information asymmetry between investors (including shareholders and other users of financial statements, including the public) and the management of the public company. In the case of audits of brokers and dealers, the audit is intended also to mitigate the problems related to the information asymmetry between the customers of the brokers and dealers, who use the services of the brokers and dealers to invest in securities and other financial instruments, and the management of the brokers and dealers. In addition, it may also help attenuate the information asymmetry between management and the other users of financial statements, such as counterparties and regulatory authorities.



The information asymmetry between the management of brokers and dealers and their customers about the brokers' and dealers' financial condition may be significant. Unlike the owners of brokers and dealers, who themselves may be managers and thus have minimal or no information asymmetry, customers of brokers and dealers are likely to be large in number, geographically distributed, and not expert in the management or operation of brokers and dealers. Such information asymmetry between the management and the customers of brokers and dealers makes the role of auditing important to enhance the reliability of financial information.

The proposal is not expected to have a widespread impact on the audits of brokers and dealers that are not issuer subsidiaries, since there are likely few instances in which such audits involve the use of other auditors. However, in those instances in which other auditors are used, 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 costs of performing the proposed procedures are unlikely to be disproportionate to the benefits of the proposed procedures.

Question:

14. The Board requests comment generally on the analysis of the impacts of the proposal on audits of brokers and dealers. Are there reasons why the proposal should not apply to audits of brokers and dealers? Are there any factors specifically related to audits of brokers and dealers that should affect the application of the proposal to those audits?

VII. Effective Date

The Board seeks comment on the amount of time auditors would need after adoption of the proposed amendments and new auditing standard, and approval by the SEC, before they become effective.

Question:

15. How much time following SEC approval would accounting firms need to implement the proposed requirements?

VIII. List of Appendices

The Board's proposal includes this release and the following appendices:

- Appendix 1 contains the text of proposed amendments to AS 2101, 1201, 1215, and 1220;



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- Appendix 2 contains the text of the proposed new standard for situations in which the auditor divides responsibility for the audit with another accounting firm;
- Appendix 3 contains the text of other related proposed amendments to PCAOB auditing standards and rules;
- Appendix 4 details certain aspects of the proposed amendments and proposed new standard, including significant differences with the analogous standards of the IAASB and the ASB, and provides additional questions for commenters; and
- Appendix 5 describes certain characteristics of self-identified EGCs.

IX. Opportunity for Public Comment

The Board is seeking comments on all aspects of its proposal, as well as specific comments on the proposed amendments and proposed new standard. Among other things, the Board is seeking comment on the economic analysis relating to its proposal, including potential costs. To assist the Board in evaluating such matters, the Board is requesting relevant information and empirical data regarding the proposed amendments and standard.

Written comments should be sent to the Office of the Secretary, PCAOB, 1666 K Street, NW, Washington, DC 20006-2803. Comments also may be submitted by e-mail to comments@pcaobus.org or through the Board's website at www.pcaobus.org. All comments should refer to PCAOB Rulemaking Docket Matter No. 042 in the subject or reference line and should be received by the Board no later than July 29, 2016.

The Board will consider all comments received. After the close of the comment period, the Board will determine whether to adopt final rules, with or without changes from the proposal. Any 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. Standards are rules of the Board under Sarbanes-Oxley.

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On the 12th day of April, in the year 2016, 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

April 12, 2016



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Appendix 1—Proposed Amendments Relating to
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APPENDIX 1

Proposed Amendments Relating to the Performance of Audits Involving Other Auditors

This appendix proposes amendments to AS 2101 (currently Auditing Standard No. 9), *Audit Planning*, AS 1201 (currently Auditing Standard No. 10), *Supervision of the Audit Engagement*, AS 1215 (currently Auditing Standard No. 3), *Audit Documentation*, and AS 1220 (currently Auditing Standard No. 7), *Engagement Quality Review*. Language that would be deleted by the proposed amendments is ~~struck through~~. Language that would be added is underlined. The presentation of the proposed amendments by showing deletions and additions to existing sentences, paragraphs, and footnotes is intended to assist readers in comprehending the Board's proposed changes to the auditing standard. The Board's proposed amendments consist of only the deleted or added language. This presentation does not constitute or represent a reproposal of all or of any other part of the auditing standard, as amended by this proposal.¹

Auditing Standards Affected

PCAOB Standard	Para- graph or Appendix	Subject Heading of Paragraph(s) Affected	Action	Page
Planning an Audit				
AS 2101 (currently Auditing Standard No. 9), <i>Audit Planning</i>	.04	Planning an Audit	Add AS 2101.04A	p. A1–4
AS 2101	.09	Planning an Audit: Audit Strategy	Make conforming amendment	p. A1–7
AS 2101	.14	Planning an Audit: Multi-location Engagements	Make conforming amendment	p. A1–10
AS 2101	.16	Persons with Specialized Skill or	Make conforming amendment	p. A1–11

¹ Parenthetical citations to current auditing standards of the PCAOB are provided for reference purposes and would not appear in the final amendments.



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PCAOB Standard	Para-graph or Appendix	Subject Heading of Paragraph(s) Affected	Action	Page
		Knowledge		
AS 2101	Appendix A	Definitions	Add AS 2101.A3–.A6	p. A1–12
AS 2101	Appendix B	Additional Requirements for the Lead Auditor When Planning an Audit That Involves Other Auditors or Referred-to Auditors	Add	p. A1–14
Supervision of the Audit Engagement				
AS 1201 (currently Auditing Standard No. 10), <i>Supervision of the Audit Engagement</i>	.03	Responsibility of the Engagement Partner for Supervision	Amend	p. A1–17
AS 1201	Appendix A	Definitions	Add AS 1201.A3–.A5	p. A1–20
AS 1201	Appendix B	Procedures to Be Performed by the Lead Auditor with Respect to the Supervision of the Other Auditors' Work	Add	p. A1–22
Engagement Quality Review				
AS 1220 (currently Auditing Standard No. 7), <i>Engagement Quality Review</i>	.10a	Engagement Quality Review for an Audit: Engagement Quality Review Process	Amend	p. A1–25



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PCAOB Standard	Para-graph or Appendix	Subject Heading of Paragraph(s) Affected	Action	Page
Audit Documentation				
AS 1215 (currently Auditing Standard No. 3), <i>Audit Documentation</i>	.18, .19	Retention of and Subsequent Changes to Audit Documentation	Make conforming amendment: AS 1215.18, .19 Add AS 1215.19A	p. A1–26

Auditing Standard and Interpretation Superseded

Auditing Standard or Interpretation
AS 1205 (currently AU sec. 543), <i>Part of the Audit Performed by Other Independent Auditors</i>
AI 10, <i>Part of the Audit Performed by Other Independent Auditors: Auditing Interpretations of AS 1205</i> (currently AU sec. 9543, <i>Part of Audit Performed by Other Independent Auditors: Auditing Interpretations of Section 543</i>)

AS 2101 (currently Auditing Standard No. 9), *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 in fulfilling this



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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

.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.

.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 and ethics requirements, 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.



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- c. Establish an understanding of the terms of the audit engagement with the audit committee in accordance with AS 1301 (currently Auditing Standard No. 16), *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* (currently AU sec. 161, *The Relationship of Generally Accepted Auditing Standards to Quality Control Standards*), explains how the quality control standards relate to the conduct of audits.

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 committee⁶ or management;



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- 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.



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.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 activities⁹ 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 the Performance of Work*, and paragraph .06 of AS 1201, *Supervision of the Audit Engagement*. See also, Appendix B of AS 1201, which describes further procedures to be performed by the lead auditor with respect to the supervision of the other auditors' work, in conjunction with the required supervisory activities set forth in AS 1201.

⁹ Paragraph .06 of this standard.

¹⁰ See, e.g., ~~paragraph .06 of AS 1015, *Due Professional Care in the Performance of Work*~~ AS 1015.06, paragraph .16 of this standard, and paragraph .05a. of AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*.

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



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- 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.

.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



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- 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 possibility¹⁶ 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 2201¹⁷ for considerations when a company has multiple locations or business units.

¹⁴ Paragraph .66 of AS 2401 (currently AU sec. 316), *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.



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.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 Other Independent Auditors*, describes the auditor's responsibilities regarding using the work and reports of 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.⁴⁸~~ In an audit that involves other auditors or referred-to auditors^{18A}, those situations, 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^{18A} 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.

⁴⁸ ~~For integrated audits, see also AS 2201.C8–.C11.~~

^{18A} AS 2110.49–.53 describe conducting a discussion among engagement team members regarding risks of material misstatement.

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.



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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 (currently Auditing Standard No. 6), *Evaluating Consistency of Financial Statements*.



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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 accountants²⁰ 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 (currently Auditing Standard No. 7), *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.²¹

²⁰ See paragraph (a)(ii) in PCAOB Rule 1001, *Definitions of Terms Employed in Rules*.

²¹ See AS 1210.



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.A4 Lead auditor –

- a. The registered public accounting firm²² 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 1201.²³

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

²² 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, 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.

.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 units²⁴ 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.

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



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Appendix B – Additional Requirements for the Lead Auditor When Planning an Audit that Involves Other Auditors or Referred-to Auditors

.B1 For engagements that involve other auditors or referred-to auditors, this appendix describes additional procedures to be performed by the lead auditor with respect to planning the audit.

Note: The lead auditor must supervise, in accordance with AS 1201,²⁵ 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.²⁶

²⁵ AS 1201 establishes requirements regarding supervision of the audit engagement, including supervising the work of engagement team members.

²⁶ AS 1206 establishes requirements for the 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 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.

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

.B2 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 risks of material misstatement associated with the portion of the company's financial statements for which the engagement partner's firm performs audit procedures (which includes considering the portion's materiality), in comparison with the portions for which the other auditors perform audit procedures or the portions audited by the referred-to auditors.

.B3 In an integrated audit of financial statements and internal control over financial reporting, 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



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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.

Other Auditors' Compliance with Independence and Ethics

B4. In an audit that involves other auditors,²⁷ the lead auditor should determine each other auditor's compliance with the SEC and PCAOB independence and ethics requirements by:

- a. Gaining an understanding of each other auditor's knowledge of the SEC and PCAOB independence and ethics requirements and their experience in applying the requirements; and
- b. Obtaining a written representation from each other auditor that it is in compliance with SEC and PCAOB independence and ethics requirements.

Note: The lead auditor's determination of each other auditor's compliance with the SEC and PCAOB independence and ethics requirements is not limited to preliminary engagement activities and should be reevaluated with changes in circumstances.

Note: If the lead auditor becomes aware of information during the course of the audit that contradicts a representation made by an other auditor regarding its compliance with the SEC and PCAOB 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.

²⁷ See AS 1206 for requirements for the lead auditor relating to the referred-to auditor's compliance with the SEC and PCAOB independence and ethics requirements.

Registration Status of Other Auditors

.B5 In an audit that involves an other 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, the lead auditor may use an other auditor only if the other auditor is registered pursuant to the rules of the PCAOB.²⁸



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²⁸ 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 referred-to auditor.

Qualifications of and Communication with Other Auditors

.B6 At the beginning of an audit that involves other auditors, the lead auditor should:

- a. Gain an understanding of the knowledge, skill, and ability of the other auditors who assist the lead auditor with planning or supervision,²⁹ 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. Determine that it is able to communicate with the other auditors and gain access to their work papers.³⁰

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

²⁹ See AS 1015.06, according to which "[a]uditors should be assigned to tasks and supervised commensurate with their level of knowledge, skill, and ability", and AS 2301.05a, which describes making appropriate assignments of significant engagement responsibilities. See also AS 1201.B3, which describes assisting the lead auditor with supervision in a multi-tiered engagement team.

³⁰ See, e.g., AS 1201.05, and Appendix B of AS 1201, which establish requirements for the auditor's review of work performed by engagement team members. See also AS 1215.18, 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.

* * *



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AS 1201 (currently Auditing Standard No. 10), *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 defined in Appendix A, *Definitions*, are set in **boldface type** the first time they appear.

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**⁴ 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 ~~and~~ 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

Note: Appendix B describes further 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.

² AS 1210 (currently AU sec. 336), *Using the Work of a Specialist*.

³ ~~AS 1205, *Part of the Audit Performed by Other Independent Auditors*.~~



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⁴ AS 2605, *Consideration of the Internal Audit Function* (currently AU sec. 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of the Financial Statements*).

⁵ Paragraphs .16–.19 of AS 2201 (currently Auditing Standard No. 5), *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 (currently AU sec. 230), *Due Professional Care in the Performance of Work*.

.04 The engagement partner may seek assistance from appropriate engagement team members 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



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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 (currently Auditing Standard No. 13), *The Auditor's Responses to the Risks of Material Misstatement*, establish requirements regarding the appropriate assignment of engagement team members.

⁸ AS 2110 (currently Auditing Standard No. 12), *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 (currently Auditing Standard No. 9), *Audit Planning*, AS 2110.74, and paragraphs .20–.23 and .35–.36 of AS 2810 (currently Auditing Standard No. 14), *Evaluating Audit Results*.

¹⁰ AS 2810 describes the auditor's responsibilities for evaluating the results of the audit, and AS 1215 (currently Auditing Standard No. 3), *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



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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.

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:



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(1) Partners, principals, and shareholders of, and accountants¹⁴ 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 (currently Auditing Standard No. 7), *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 firm¹⁶ 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



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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.

Appendix B – Procedures to Be Performed by the Lead Auditor with Respect to the Supervision of the Other Auditors' Work

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

Note: The lead auditor should hold discussions with and obtain information from the other auditors, as necessary for the performance of procedures described in this appendix.

.B2 In supervising the work of other auditors, the lead auditor should:¹⁸

- a. Inform the other auditor of the following in writing:
 - (1) The scope of work to be performed by the other auditor; and



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(2) Tolerable misstatement,¹⁹ the identified risks of material misstatement,²⁰ and, if determined, the amount below which misstatements are clearly trivial and do not need to be accumulated²¹ relevant to the work requested to be performed.

b. Obtain and review the other auditor's description of the nature, timing, and extent of audit procedures to be performed pursuant to the scope of work described in paragraph .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: Based on the necessary extent of supervision of the other auditor's work by the lead auditor, it may be necessary for the lead auditor (rather than the other auditor) to determine the nature, timing, and extent of procedures to be performed.

c. Direct the other auditor to provide for review specified documentation with respect to the work requested to be performed;²²

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

e. Determine, based on a review of the documentation and written report provided by the other auditor (pursuant to paragraphs .B2c and .B2d of this appendix), discussions with the other auditor, and other information obtained during the audit:

(1) Whether the other auditor complied with the written communications received pursuant to paragraphs .B2a and .B2b; and

(2) Whether additional audit evidence should be obtained with respect to the work performed by the other auditor, for example, to address a previously unidentified risk of material misstatement or in a situation in which 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.



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¹⁹ See paragraphs .08–.10 of AS 2105 (currently Auditing Standard No. 11), *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 locations regarding risks of material misstatement.

²¹ See AS 2810.10–.11.

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

²³ See AS 2810.35–.36.

.B3 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 the lead auditor in supervising a second other auditor.²⁴ In these situations, the lead auditor may direct the first other auditor to perform the procedures in paragraphs .B2b through .B2e with respect to the second other auditor on behalf of the lead auditor, 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 remains responsible for informing directly both the first other auditor and second other auditor of the matters in paragraph .B2a.

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

* * *



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AS 1220 (currently Auditing Standard No. 7), *Engagement Quality Review*

* * *

Engagement Quality Review for an Audit

Engagement Quality Review Process

.09 In an audit engagement, the engagement quality reviewer should evaluate the significant judgments made by the engagement team and the related conclusions reached in forming the overall conclusion on the engagement and in preparing the engagement report. To evaluate such judgments and conclusions, the engagement quality reviewer should, to the extent necessary to satisfy the requirements of paragraphs .10 and .11: (1) hold discussions with the engagement partner and other members of the engagement team, and (2) review documentation.

.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}



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^{3A} The terms "lead auditor," "other auditors," and "referred-to auditor" have the same meaning as in Appendix A of AS 2101, *Audit Planning*. AS 2101.B2 and .B3 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.

* * *

AS 1215 (currently Auditing Standard No. 3), *Audit Documentation*

* * *

Retention of and Subsequent Changes to Audit Documentation

* * *

.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} ~~(including auditors associated with other offices of the firm, affiliated firms, or non-affiliated firms),~~ must be retained by or be accessible to the office issuing the auditor's report.⁴

^{3A} The term "other auditors," as used in this standard, has the same meaning as in Appendix A of AS 1201.

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 ~~on whose opinion or services the auditor relies.~~ 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 offices of the firm and other auditors ~~(including auditors associated with other offices of the firm, affiliated firms, or non-affiliated firms):~~

- a. An engagement completion document consistent with paragraphs .12 and .13.



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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 other offices of the firm and~~the~~ 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*.~~

.19A Audit documentation of the office issuing the auditor's report must contain a list of additional work papers of other auditors (beyond those described in paragraph .19) that were reviewed by the lead auditor^{4A} but not retained by the lead auditor, if any. The list



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must include a description of the work papers reviewed, the reviewer, and the date of such review.

Note: According to paragraph .18, audit documentation supporting the work performed by other auditors must be retained by or be accessible to the office issuing the auditor's report.

^{4A} The term "lead auditor," as used in this paragraph, has the same meaning as in Appendix A of AS 1201.



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APPENDIX 2

Proposed AS 1206: Dividing Responsibility for the Audit with Another Accounting Firm¹

Introduction

.01 This standard establishes requirements for the **lead auditor**² regarding dividing responsibility for the audit of the company's financial statements³ and, if applicable, internal control over financial reporting with a **referred-to auditor**.⁴

Note: AS 2101 (currently Auditing Standard No. 9), *Audit Planning*, establishes requirements regarding serving as the lead auditor.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 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

¹ Parenthetical citations to current auditing standards of the PCAOB are provided for reference purposes and would not appear in the final standard.

² Terms defined in Appendix A, *Definitions*, are set in **boldface type** the first time they appear.

³ 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.

⁴ For integrated audits, see also paragraphs .C8 through .C11 of AS 2201 (currently Auditing Standard No. 5), *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.

⁵ See paragraphs .B2 and .B3 of AS 2101.



supervision of the work of the engagement team members, including those not employed by the lead auditor.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 (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 units⁷ audited by the referred-to auditor into the company's financial statements.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 request a written representation from the referred-to auditor that the referred-to auditor is:

- a. In compliance with the independence and ethics requirements of the PCAOB and the U.S. Securities and Exchange Commission ("SEC"); and
- b. Duly licensed to practice under the laws of the jurisdiction that apply to the work of the referred-to auditor.

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

⁷ The term "business units" includes subsidiaries, divisions, branches, components, or investments.

⁸ See paragraphs .30 and .31 of AS 2810, *Evaluating Audit Results*.



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.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 audit and issued an auditor's report in accordance with the standards of the PCAOB;⁹
- b. The financial statements of the company's business unit audited by the referred-to auditor were prepared using the same financial reporting framework as the financial reporting framework used to prepare the company's financial statements;
- c. The lead auditor determines, based on inquiries made to the referred-to auditor and other information obtained by the lead auditor during the audit, that the referred-to auditor knows the relevant requirements of the applicable financial reporting framework, standards of the PCAOB, and financial reporting requirements of the SEC;
- d. The representation from the referred-to auditor described in paragraph .05 and other information obtained by the lead auditor during the audit indicates that:
 - (1) The referred-to auditor is in compliance with the independence and ethics requirements of the PCAOB and the SEC; and
 - (2) The referred-to auditor is duly licensed to practice under the laws of the jurisdiction that apply to the work of the referred-to auditor; and
- e. 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

⁹ AS 3101, *Reports on Audited Financial Statements*, applies to auditors' reports issued in connection with 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 audits of management's assessment of the effectiveness of internal control over financial reporting that is integrated with an audit of the financial statements.



statements and, if applicable, internal control over financial reporting, is registered pursuant to the rules of the PCAOB.¹⁰

.07 In situations in which the lead auditor is unable to divide responsibility with another accounting firm (e.g., due to concerns about the competence or independence of the referred-to auditor), 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 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, 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.¹¹

- c. Withdraw from the engagement.

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."

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 3101 (currently AU sec. 508), *Reports on Audited Financial Statements*, 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)."



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, 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 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;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 an example of reporting by the lead auditor indicating the division of responsibility when making reference to the audit and report of the referred-to 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.¹³

.09 If the report of the referred-to auditor is other than a standard report, the lead auditor should make reference to the departure from the standard report and its

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.

¹³ See, e.g., AS 2201.C10.



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disposition in the lead auditor's report, unless the matter is clearly trivial to the company's financial statements.



APPENDIX A – Definitions

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

.A2 Lead auditor –

- a. The registered public accounting firm¹⁴ 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 1201.¹⁵

.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 units¹⁶ 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.

¹⁴ See paragraph (r)(i) in PCAOB Rule 1001, *Definitions of Terms Employed in Rules*, which defines the term registered public accounting firm.

¹⁵ 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."

¹⁶ The term "business units" includes subsidiaries, divisions, branches, components, or investments.



APPENDIX B – Example 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 is an example of reporting by the lead auditor indicating the division of responsibility when making reference to the audit and report of the referred-to auditor:

Report of Independent Registered Public Accounting Firm¹⁷

[Introductory paragraphs]

We have audited the accompanying consolidated balance sheets of X Company and subsidiaries as of December 31, 20X3 and 20X2, and the related consolidated statements of operations, stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 20X3. We also have audited X Company's 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)*"]. X Company's management is responsible for these 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 these financial statements and an opinion on the company's internal control over financial reporting based on our audits.

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, respectively, and total revenues constituting XX percent, YY percent, and ZZ percent of consolidated revenues for the years

¹⁷ Proposed Auditing Standards—The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion; The Auditor's Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor's Report; and Related Amendments to PCAOB Standards, PCAOB Release No. 2013-005, (Aug. 13, 2013) proposed a number of changes to the auditor's report.



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ended December 31, 20X3, 20X2, and 20X1, 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.

[Scope paragraph]

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. 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. We believe that our audits and the report of Firm ABC provide a reasonable basis for our opinions.

[Definition paragraph]

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.



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[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)*"].

[Signature]

[City and State or Country]

[Date]



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APPENDIX 3

Other Related Proposed Amendments to PCAOB Auditing Standards and Rules¹

In connection with the proposed amendments to AS 1201 (currently Auditing Standard No. 10), *Supervision of the Audit Engagement*; AS 1215 (currently Auditing Standard No. 3), *Audit Documentation*; AS 1220 (currently Auditing Standard No. 7), *Engagement Quality Review*; and AS 2101 (currently Auditing Standard No. 9), *Audit Planning*, the Board is proposing other related amendments, including conforming amendments, to several of its auditing standards and a rule ("other proposed amendments").² Some of the other proposed amendments relate to changes made to conform to the Board's proposed auditing standard, AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm* (see Appendix 2 of this release).

Language that would be deleted by the other proposed amendments is ~~struck through~~. Language that would be added is underlined. The presentation of the other proposed amendments by showing deletions and additions to existing sentences, paragraphs and footnotes is intended to assist readers in easily comprehending the Board's proposed changes to auditing standards. The Board's other proposed amendments consist of only the deleted or added language. This presentation does not constitute or represent a reproposal of all or of any other part of a standard that may be amended.

¹ Parenthetical citations to current auditing standards of the PCAOB are provided for reference purposes and would not appear in the final amendments.

² A number of the Board's pending rulemaking projects include proposals that would supersede, amend, or delete paragraphs of PCAOB auditing standards and auditing interpretations for which other proposed amendments are included in this appendix. These projects include PCAOB Release No. 2013-005, *Proposed Auditing Standards—The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion, The Auditor's Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor's Report, and Related Amendments to PCAOB Standards* (Aug. 13, 2013). If, prior to the conclusion of this rulemaking, the Board adopts standards and related amendments that affect the other proposed amendments in this release, the Board may make conforming changes to these other proposed amendments.



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This proposal would supersede AS 1205 (currently AU sec. 543), *Part of the Audit Performed by Other Independent Auditors*, and AI 10, *Part of the Audit Performed by Other Independent Auditors: Auditing Interpretations of AS 1205* (currently AU sec. 9543, *Part of Audit Performed by Other Independent Auditors: Auditing Interpretations of Section 543*).

Certain provisions of AS 1205 are referenced in other PCAOB auditing standards. The other proposed amendments would incorporate these referenced provisions, modified as appropriate, directly into the text of the auditing standards that currently refer to them and would update other references to auditing standards and terminology to conform to requirements of the proposed amendments to AS 1201, AS 2101, and AS 1206.

The Board is requesting comments on all aspects of the proposed amendments.

Auditing Standards and Rule Affected

PCAOB Standard or Rule	Paragraph, Section, or Appendix	Subject Heading of Paragraph(s) or Appendix Affected	Action	Page
AS 1301 (currently Auditing Standard No. 16), <i>Communications with Audit Committees</i>	.10	Obtaining Information and Communicating the Audit Strategy: Overall Audit Strategy, Timing of the Audit, and Significant Risks	Make conforming amendment	p. A3–7
AS 2110 (currently Auditing Standard No. 12), <i>Identifying and Assessing Risks of Material Misstatement</i>	.11A	Obtaining an Understanding of the Company and its Environment: Nature of the Company	Make conforming amendment	p. A3–9
AS 2201 (currently Auditing Standard No. 5), <i>An Audit of Internal Control Over Financial</i>	Appendix B	Special Topics: Use of Service Organizations	Make conforming amendment to AS 2201.B23	p. A3–10



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PCAOB Standard or Rule	Para- graph, Section, or Appendix	Subject Heading of Paragraph(s) or Appendix Affected	Action	Page
<i>Reporting That Is Integrated with An Audit of Financial Statements</i>				
AS 2201	Appendix C	Special Reporting Situations: Report Modifications	Make conforming amendment to AS 2201.C1; Amend AS2201.C8– .C11	p. A3–10
AS 2401 (currently AU sec. 316), <i>Consideration of Fraud in a Financial Statement Audit</i>	.53	Responding to Assessed Fraud Risks: Responses Involving the Nature, Timing, and Extent of Procedures to Be Performed	Make conforming amendment	p. A3–13
AS 2401	.61	Audit Procedures Performed to Specifically Address the Risk of Management Override of Controls	Make conforming amendment	p. A3–14
AS 2410 (currently Auditing Standard No. 18), <i>Related Parties</i>	.03	Performing Risk Assessment Procedures to Obtain an Understanding of the Company's Relationships and Transactions with Its Related Parties	Make conforming amendment	p. A3–16
AS 2410	.09	Communicating with the Audit Engagement Team	Make conforming	p. A3–17



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PCAOB Standard or Rule	Paragraph, Section, or Appendix	Subject Heading of Paragraph(s) or Appendix Affected	Action	Page
		and Other Auditors	amendment to subject heading; Amend AS 2410.09	
AS 2410	.16	Evaluating Whether the Company Has Properly Identified Its Related Parties and Relationships and Transactions with Related Parties	Make conforming amendment	p. A3–18
AS 2503 (currently AU sec. 332), <i>Auditing Derivative Instruments, Hedging Activities, and Investments in Securities</i>	.28	Designing Substantive Procedures Based on Risks Assessments: Financial Statement Assertions: Valuation	Make conforming amendment	p. A3–20
AS 2601, <i>Consideration of an Entity's Use of a Service Organization</i> (currently AU sec. 324, <i>Service Organizations</i>)	.01	Introduction and Applicability	Make conforming amendment	p. A3–20
AS 2601	.18–.19	Considerations in Using a Service Auditor's Report	Make conforming amendment to AS 2601.18; Amend AS 2601.19	p. A3–21



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PCAOB Standard or Rule	Para- graph, Section, or Appendix	Subject Heading of Paragraph(s) or Appendix Affected	Action	Page
AS 2605, <i>Consideration of the Internal Audit Function</i> (currently AU sec. 322, <i>The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements</i>)	.19	Extent of the Effect of the Internal Auditors' Work	Make conforming amendment	p. A3–22
AS 2610, <i>Initial Audits—Communications Between Predecessor and Successor Auditors</i> (currently AU sec. 315, <i>Communications Between Predecessor and Successor Auditors</i>)	.12	Successor Auditor's Use of Communications	Make conforming amendment	p. A3–23
AS 2610	.16	Audits of Financial Statements That Have Been Previously Audited	Make conforming amendment	p. A3–24
AS 2710 (currently AU sec. 550), <i>Other Information in Documents Containing Audited Financial Statements</i>	.04	-	Make conforming amendment	p. A3–24
AS 3101 (currently AU sec. 508), <i>Reports on Audited Financial Statements</i>	.11	Explanatory Language Added to the Auditor's Standard Report	Amend	p. A3–25



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PCAOB Standard or Rule	Para-graph, Section, or Appendix	Subject Heading of Paragraph(s) or Appendix Affected	Action	Page
AS 3101	.12-.13	Opinion Based in Part on Report of Another Auditor	Amend	p. A3-27
AS 3101	.71	Reports on Comparative Financial Statements: Report of Predecessor Auditor: Predecessor Auditor's Report Reissued	Amend	p. A3-28
AS 3305 (currently AU sec. 623), <i>Special Reports</i>	.31	Circumstances Requiring Explanatory Language in an Auditor's Special Report	Amend	p. A3-29
AS 4105, <i>Reviews of Interim Financial Information</i> (currently AU sec. 722, <i>Interim Financial Information</i>)	.18	Analytical Procedures, Inquiries, and Other Review Procedures	Make conforming amendment	p. A3-32
AS 4105	.39-.40	The Accountant's Report on a Review of Interim Financial Information: Form of Accountant's Review Report	Make conforming amendment	p. A3-35
AS 6115 (currently Auditing Standard No.4), <i>Reporting on Whether a Previously Reported Material Weakness Continues to Exist</i>	.24	Planning the Engagement	Make conforming amendment	p. A3-38



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PCAOB Standard or Rule	Para-graph, Section, or Appendix	Subject Heading of Paragraph(s) or Appendix Affected	Action	Page
AS 6115	.40	Opinions, Based in Part, on the Work of Another Auditor	Amend	p. A3–38
Rule 1001	(p)(ii)	Play a Substantial Role in the Preparation or Furnishing of an Audit Report	Make conforming amendment	p. A3–39

AS 1301 (currently Auditing Standard No. 16), *Communications with Audit Committees*

Obtaining Information and Communicating the Audit Strategy

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:

- a. The nature and extent of specialized skill or knowledge needed to perform the planned audit procedures or evaluate the audit results related to significant risks;⁹
- b. The extent to which the auditor plans to use the work of the company's internal auditors in an audit of financial statements;¹⁰



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- c. The extent to which the auditor plans to use the work of internal auditors, company personnel (in addition to internal auditors), and third parties working under the direction of management or the audit committee when performing an audit of internal control over financial reporting;¹¹
- d. ~~The names, locations, and planned responsibilities¹² of other independent public accounting firms or other persons, who are not employed by the auditors,~~ that perform audit procedures in the current period audit or referred-to auditors that audit portions of the company's financial statements in the current period audit and, if applicable, internal control over financial reporting;^{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 basis for the auditor's determination that the auditor can serve as principal auditor, if significant parts of the audit are to be performed by other auditors~~In an audit that involves other auditors or referred-to auditors, the basis for the engagement partner's determination that the participation of his or her firm is sufficient to serve as the lead auditor.¹³

⁹ See AS 2101.16 for the requirement for the auditor to determine whether specialized skill or knowledge is needed to perform appropriate risk assessments, plan or perform audit procedures, or evaluate audit results.

¹⁰ See AS 2605, *Consideration of the Internal Audit Function*, which describes the auditor's responsibilities related to the work of internal auditors.

¹¹ See paragraphs .16–.19 of AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, which describe the auditor's responsibilities related to using the work of others in an audit of internal control over financial reporting.

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 multi-location engagements.



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^{12A} The terms "other auditor" and "referred-to auditor" in this standard have the same meaning as in Appendix A of AS 2101, *Audit Planning*.

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; AS 2101.B2 and .B3, which establish requirements regarding serving as the lead auditor.

* * *

AS 2110 (currently Auditing Standard No. 12), *Identifying and Assessing Risks of Material Misstatement*

* * *

Obtaining an Understanding of the Company and Its Environment

* * *

Nature of the Company

* * *

.11A If the auditor serves as a referred-to auditor in accordance with AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*, as part of obtaining an understanding of the company, the referred-to auditor should consider making inquiries of the lead auditor as to matters that may be significant to the referred-to auditor's own audit. Such matters may include transactions, adjustments, or other matters that have come to the attention of the lead auditor and may require adjustment to or disclosure in the financial statements audited by the referred-to auditor.

* * *



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AS 2201 (currently Auditing Standard No. 5), *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*

* * *

APPENDIX B – Special Topics

* * *

Use of Service Organizations

* * *

.B23 In determining whether the service auditor's report provides sufficient evidence to support the auditor's opinion, the auditor should make inquiries concerning the service auditor's reputation, competence, and independence. Appropriate sources of information concerning the professional reputation of the service auditor ~~are discussed in paragraph .10a of AS 1205, *Part of the Audit Performed by Other Independent Auditors*~~ may include professional organizations and other relevant parties.

* * *

APPENDIX C – Special Reporting Situations

Report Modifications

.C1 The auditor should modify his or her report if any of the following conditions exist.

- a. Elements of management's annual report on internal control are incomplete or improperly presented,
- b. There is a restriction on the scope of the engagement,
- c. The auditor decides to refer to the report of another public accounting firm ~~auditors~~ as the basis, in part, for the auditor's own report,



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- d. There is other information contained in management's annual report on internal control over financial reporting, or
- e. Management's annual certification pursuant to Section 302 of the Sarbanes-Oxley Act is misstated.

* * *

~~.C8 *Opinions Based, in Part, on the Report of Another Public Accounting Firm Auditor*. When another auditor has audited the financial statements and internal control over financial reporting of one or more subsidiaries, divisions, branches, or components of the company, the auditor should determine whether he or she may serve as the principal auditor and use the work and reports of another auditor as a basis, in part, for his or her opinion. AS 1205, *Part of the Audit Performed by Other Independent Auditors*, provides direction on the auditor's decision of whether to serve as the principal auditor of the financial statements. If the auditor decides it is appropriate to serve as the principal auditor of the financial statements, then that auditor also should be the principal auditor of the company's internal control over financial reporting. This relationship results from the requirement that an audit of the financial statements must be performed to audit internal control over financial reporting; only the principal auditor of the financial statements can be the principal auditor of internal control over financial reporting. In this circumstance, the principal 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 principal auditor of internal control over financial reporting. Because an audit of the financial statements must be performed to audit internal control over financial reporting, only the lead auditor of the financial statements can be the lead auditor of internal control over financial reporting. In an audit that involves other auditors or referred-to auditors, the lead auditor of the consolidated 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.~~^{*}

^{*} AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*, establishes requirements for situations in which the lead auditor of the consolidated financial statements and, if applicable, internal control over financial reporting makes reference in the auditor's report to the referred-to auditor's report on the financial statements and, if applicable, internal control over financial reporting of one or more of the company's business units. See Appendix A of AS 2101, *Audit Planning*, for the definitions of lead auditor, other auditor, and referred-to auditor. See



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a/so AS 2101.B2 and .B3, which establish requirements regarding serving as the lead auditor.

~~.C9—When serving as the principal auditor of internal control over financial reporting, the auditor should decide whether to make reference in the report on internal control over financial reporting to the audit of internal control over financial reporting performed by the other auditor. In these circumstances, the auditor's decision is based on factors analogous to those of the auditor who uses the work and reports of other independent auditors when reporting on a company's financial statements as described in AS 1205.~~

~~.C10 The decision about whether to make reference to another auditor in the 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. For example, the audit report on the financial statements may make reference to the audit of a significant equity investment performed by another independent auditor, but the report on internal control over financial reporting might not make a similar reference because management's assessment of internal control over financial reporting ordinarily would not extend to controls at the equity method investee. The lead auditor's decision about making reference to the referred-to auditor in the 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. For example, the audit report on the financial statements may make reference to the audit of a significant equity investment performed by the referred-to auditor, but the report on internal control over financial reporting might not make a similar reference because management's assessment of internal control over financial reporting ordinarily would not extend to controls at the equity method investee.¹~~

¹ See paragraph .B15, for further discussion of the evaluation of the controls over financial reporting for an equity method investment.

~~.C11 When the auditor decides to make reference to the report of the other auditor as a basis, in part, for his or her opinion on the company's internal control over financial reporting, the auditor should refer to the report of the other auditor when describing the scope of the audit and when expressing the opinion. When the lead auditor makes reference to the report of the referred-to auditor as a basis, in part, for the lead auditor's opinion on the company's internal control over financial reporting, the lead auditor should refer to the report of the referred-to auditor when describing the scope of the audit and when expressing the opinion.~~



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* * *

AS 2401 (currently AU sec. 316), *Consideration of Fraud in a Financial Statement Audit*

* * *

Responding to Assessed Fraud Risks

* * *

Responses Involving the Nature, Timing, and Extent of Procedures to Be Performed

* * *

.53 The following are examples of responses to assessed fraud risks involving the nature, timing, and extent of audit procedures:

- Performing procedures at locations on a surprise or unannounced basis, for example, observing inventory on unexpected dates or at unexpected locations or counting cash on a surprise basis.
- Requesting that inventories be counted at the end of the reporting period or on a date closer to period end to minimize the risk of manipulation of balances in the period between the date of completion of the count and the end of the reporting period.
- Making oral inquiries of major customers and suppliers in addition to sending written confirmations, or sending confirmation requests to a specific party within an organization.
- Performing substantive analytical procedures using disaggregated data, for example, comparing gross profit or operating margins by location, line of business, or month to auditor-developed expectations.²⁰
- Interviewing personnel involved in activities in areas in which a fraud risk has been identified to obtain their insights about the risk and how controls address the risk. (See AS 2110.54)



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- If other ~~independent~~ auditors or referred-to auditors are auditing the financial statements of one or more ~~subsidiaries, divisions, or branches~~ of the company's business units, discussing with them the extent of work that needs to be performed to address the fraud risk resulting from transactions and activities among these ~~components~~ business units.^{20A}

²⁰ AS 2305 (currently Auditing Standard No. 329), *Substantive Analytical Procedures*, establishes requirements regarding performing analytical procedures as substantive tests.

^{20A} AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*, establishes requirements for the lead auditor 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.

* * *

Audit Procedures Performed to Specifically Address the Risk of Management Override of Controls

* * *

.61 The auditor should use professional judgment in determining the nature, timing, and extent of the testing of journal entries and other adjustments. For purposes of identifying and selecting specific entries and other adjustments for testing, and determining the appropriate method of examining the underlying support for the items selected, the auditor should consider:

- *The auditor's assessment of the fraud risk.* The presence of fraud risk factors or other conditions may help the auditor to identify specific classes of journal entries for testing and indicate the extent of testing necessary.
- *The effectiveness of controls that have been implemented over journal entries and other adjustments.* Effective controls over the preparation and posting of journal entries and adjustments may affect the extent of substantive testing necessary, provided that the auditor has tested the controls. However, even though controls might be implemented and



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operating effectively, the auditor's substantive procedures for testing journal entries and other adjustments should include the identification and substantive testing of specific items.

- *The entity's financial reporting process and the nature of the evidence that can be examined.* The auditor's procedures for testing journal entries and other adjustments will vary based on the nature of the financial reporting process. For many entities, routine processing of transactions involves a combination of manual and automated steps and procedures. Similarly, the processing of journal entries and other adjustments might involve both manual and automated procedures and controls. Regardless of the method, the auditor's procedures should include selecting from the general ledger journal entries to be tested and examining support for those items. In addition, the auditor should be aware that journal entries and other adjustments might exist in either electronic or paper form. When information technology (IT) is used in the financial reporting process, journal entries and other adjustments might exist only in electronic form. Electronic evidence often requires extraction of the desired data by an auditor with IT knowledge and skills or the use of an IT specialist. In an IT environment, it may be necessary for the auditor to employ computer-assisted audit techniques (for example, report writers, software or data extraction tools, or other systems-based techniques) to identify the journal entries and other adjustments to be tested.
- *The characteristics of fraudulent entries or adjustments.* Inappropriate journal entries and other adjustments often have certain unique identifying characteristics. Such characteristics may include entries (a) made to unrelated, unusual, or seldom-used accounts, (b) made by individuals who typically do not make journal entries, (c) recorded at the end of the period or as post-closing entries that have little or no explanation or description, (d) made either before or during the preparation of the financial statements that do not have account numbers, or (e) containing round numbers or a consistent ending number.
- *The nature and complexity of the accounts.* Inappropriate journal entries or adjustments may be applied to accounts that (a) contain transactions that are complex or unusual in nature, (b) contain



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significant estimates and period-end adjustments, (c) have been prone to errors in the past, (d) have not been reconciled on a timely basis or contain unreconciled differences, (e) contain intercompany transactions, or (f) are otherwise associated with an identified fraud risk. In audits of entities that have multiple locations or business units, the auditor should determine whether to select journal entries from locations or business units based on factors set forth in paragraphs .11 through .14 of AS 2101, *Audit Planning*.

- *Journal entries or other adjustments processed outside the normal course of business.* Standard journal entries used on a recurring basis to record transactions such as monthly sales, purchases, and cash disbursements, or to record recurring periodic accounting estimates generally are subject to the entity's internal controls. Nonstandard entries (for example, entries used to record nonrecurring transactions, such as a business combination, or entries used to record a nonrecurring estimate, such as an asset impairment) might not be subject to the same level of internal control. In addition, other adjustments such as consolidating adjustments, report combinations, and reclassifications generally are not reflected in formal journal entries and might not be subject to the entity's internal controls. Accordingly, the auditor should consider placing additional emphasis on identifying and testing items processed outside of the normal course of business.

* * *

AS 2410 (currently Auditing Standard No. 18), *Related Parties*

* * *

Performing Risk Assessment Procedures to Obtain an Understanding of the Company's Relationships and Transactions with Its Related Parties

.03 The auditor should perform procedures to obtain an understanding of the company's relationships and transactions with its related parties that might reasonably be expected to affect the risks of material misstatement of the financial statements in conjunction with performing risk assessment procedures in accordance with AS 2110, *Identifying and Assessing Risks of Material Misstatement*. The procedures performed to



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obtain an understanding of the company's relationships and transactions with its related parties include:

- a. Obtaining an understanding of the company's process (paragraph .04);
- b. Performing inquiries (paragraphs .05–.07); and
- c. Communicating with the ~~audit~~ engagement team and ~~other~~referred-to auditors (paragraphs .08–.09).

Note: Obtaining an understanding of the company's relationships and transactions with its related parties includes obtaining an understanding of the nature of the relationships between the company and its related parties and of the terms and business purposes (or the lack thereof) of the transactions involving related parties.

Note: Performing the risk assessment procedures described in paragraphs .04–.09 of this standard in conjunction with the risk assessment procedures required by AS 2110 is intended to provide the auditor with a reasonable basis for identifying and assessing risks of material misstatement associated with related parties and relationships and transactions with related parties.

* * *

Communicating with the ~~Audit~~ Engagement Team and ~~Other~~Referred-to Auditors

* * *

.09 If the auditor is ~~using the work of another~~serves as the lead auditor and divides responsibility for the audit with a referred-to auditor, the lead auditor should communicate to the ~~other~~referred-to auditor relevant information about related parties, including the names of the company's related parties and the nature of the company's relationships and transactions with those related parties.⁹ The lead auditor also should inquire of the ~~other~~referred-to auditor regarding the ~~other~~referred-to auditor's knowledge of any related parties or relationships or transactions with related parties that were not included in the auditor's communications.

⁹ See ~~AS 1205, Part of the Audit Performed by Other Independent Auditors~~, which describes the auditor's responsibilities regarding using the work and reports of other independent auditors who audit the financial statements of one or



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~~more subsidiaries, divisions, branches, components, or investments included in the financial statements paragraphs .B2 and .B3 of AS 2101, *Audit Planning*, which establish requirements regarding serving as the lead auditor. See also AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*, which establishes requirements for the lead auditor regarding dividing responsibility for the audit with a referred-to auditor.~~

* * *

Evaluating Whether the Company Has Properly Identified Its Related Parties and Relationships and Transactions with Related Parties

* * *

.16 If the auditor determines that a related party or relationship or transaction with a related party previously undisclosed to the auditor exists, the auditor should:

- a. Inquire of management regarding the existence of the related party or relationship or transaction with a related party previously undisclosed to the auditor and the possible existence of other transactions with the related party previously undisclosed to the auditor;
- b. Evaluate why the related party or relationship or transaction with a related party was previously undisclosed to the auditor;¹⁷
- c. Promptly communicate to appropriate members of the engagement team and ~~the referred-to auditor~~~~other auditors participating in the audit engagement~~ relevant information about the related party or relationship or transaction with the related party;
- d. Assess the need to perform additional procedures to identify other relationships or transactions with the related party previously undisclosed to the auditor;
- e. Perform the procedures required by paragraph .12 of this standard for each related party transaction previously undisclosed to the auditor that is required to be disclosed in the financial statements or determined to be a significant risk; and



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- f. Perform the following procedures, taking into account the information gathered from performing the procedures in a. through e. above:
 - i. Evaluate the implications on the auditor's assessment of internal control over financial reporting, if applicable;
 - ii. Reassess the risk of material misstatement and perform additional procedures as necessary if such reassessment results in a higher risk;¹⁸ and
 - iii. Evaluate the implications for the audit if management's nondisclosure to the auditor of a related party or relationship or transaction with a related party indicates that fraud or an illegal act may have occurred. If the auditor becomes aware of information indicating that fraud or another illegal act has occurred or might have occurred, the auditor must determine his or her responsibilities under AS 2401.79–.82, AS 2405 (currently AU sec. 317), *Illegal Acts by Clients*, and Section 10A of the Securities Exchange Act of 1934, 15 U.S.C. §78j-1.

¹⁷ See AS 2805.04, which states that if a representation made by management is contradicted by other audit evidence, the auditor should investigate the circumstances and consider the reliability of the representation made. Based on the circumstances, the auditor should consider whether his or her reliance on management's representations relating to other aspects of the financial statements is appropriate and justified.

¹⁸ See AS 2110.74, which states that when the auditor obtains audit evidence during the course of the audit that contradicts the audit evidence on which the auditor originally based his or her risk assessment, the auditor should revise the risk assessment and modify planned audit procedures or perform additional procedures in response to the revised risk assessments.

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AS 2503 (currently AU sec. 332), *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*

* * *

Designing Substantive Procedures Based on Risk Assessments

* * *

Financial Statement Assertions

* * *

Valuation

.28 *Valuation Based on an Investee's Financial Results.* For valuations based on an investee's financial results, including but not limited to the equity method of accounting, the auditor should obtain sufficient 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 whose report is satisfactory, for this purpose,¹⁴ to the investor's auditor may constitute sufficient evidential matter.

¹⁴ 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 of the ~~other~~investee's auditor, 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.

* * *

AS 2601, *Consideration of an Entity's Use of a Service Organization* (currently AU sec. 324, *Service Organizations*)

Introduction and Applicability

.01 This section provides guidance on the factors an independent auditor should consider when auditing the financial statements of an entity that uses a service



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organization to process certain transactions. This section also provides guidance for independent auditors who issue reports on the processing of transactions by a service organization for use by another auditor~~other auditors~~.

Note: When performing an integrated audit of financial statements and internal control over financial reporting, refer to paragraphs .B17–.B27 of Appendix B, *Special Topics*, of AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, regarding the use of service organizations.

* * *

Considerations in Using a Service Auditor's Report

.18 In considering whether the service auditor's report is satisfactory for his or her purposes, the user auditor should make inquiries concerning the service auditor's professional reputation. Appropriate sources of information concerning the professional reputation of the service auditor ~~are discussed in paragraph .10a of AS 1205, *Part of the Audit Performed by Other Independent Auditors*~~may include professional organizations and other relevant parties.

.19 In considering whether the service auditor's report is sufficient to meet his or her objectives, the user auditor should ~~give consideration to the guidance in AS 1205.12~~consider performing one or more of the following procedures:

- Visiting the service auditor and discussing the audit procedures followed and results thereof.
- Reviewing the audit programs of the service auditor. In some cases, it may be appropriate to issue instructions to the service auditor as to the scope of the audit work.
- Reviewing additional audit documentation of the service auditor.

If the user auditor believes that the service auditor's report may not be sufficient to meet his or her objectives, the user auditor may supplement his or her understanding of the service auditor's procedures and conclusions by discussing with the service auditor the scope and results of the service auditor's work. Also, if the user auditor believes it is necessary, he or she may contact the service organization, through the



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user organization, to request that the service auditor perform agreed-upon procedures at the service organization, or the user auditor may perform such procedures.

* * *

AS 2605, Consideration of the Internal Audit Function (currently AU sec. 322, The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements)

* * *

Extent of the Effect of the Internal Auditors' Work

* * *

.19 The responsibility to report on the financial statements rests solely with the auditor. Unlike the situation in which the lead auditor uses the work of other independent auditors ~~divides responsibility for the audit with another public accounting firm~~,⁶ this responsibility cannot be shared with the internal auditors. Because the auditor has the ultimate responsibility to express an opinion on the financial statements, judgments about assessments of inherent and control risks, the materiality of misstatements, the sufficiency of tests performed, the evaluation of significant accounting estimates, and other matters affecting the auditor's report should always be those of the auditor.

⁶ See ~~AS 1205, Part of the Audit Performed by Other Independent Auditors~~ AS 1206, Dividing Responsibility for the Audit with Another Accounting Firm.

* * *



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AS 2610, Initial Audits—Communications Between Predecessor and Successor Auditors (currently AU sec. 315, Communications Between Predecessor and Successor Auditors)

* * *

Successor Auditor's Use of Communications

.12 The successor auditor must obtain sufficient appropriate evidential matter to afford a reasonable basis for expressing an opinion on the financial statements he or she has been engaged to audit, including evaluating the consistency of the application of accounting principles. The audit evidence used in analyzing the impact of the opening balances on the current-year financial statements and consistency of accounting principles is a matter of professional judgment. Such audit evidence may include the most recent audited financial statements, the predecessor auditor's report thereon,⁸ the results of inquiry of the predecessor auditor, the results of the successor auditor's review of the predecessor auditor's working papers relating to the most recently completed audit, and audit procedures performed on the current period's transactions that may provide evidence about the opening balances or consistency. For example, evidence gathered during the current year's audit may provide information about the realizability and existence of receivables and inventory recorded at the beginning of the year. The successor auditor may also apply appropriate auditing procedures to account balances at the beginning of the period under audit and to transactions in prior periods.

⁸ The successor auditor may wish to make inquiries about the professional reputation and standing of the predecessor auditor. ~~See paragraph .10a of AS 1205, *Part of the Audit Performed by Other Independent Auditors* to one or more professional organizations or other relevant parties.~~

* * *

Audits of Financial Statements That Have Been Previously Audited

.14 If an auditor is asked to audit and report on financial statements that have been previously audited and reported on (henceforth referred to as a reaudit), the auditor considering acceptance of the reaudit engagement is also a successor auditor, and the auditor who previously reported is also a predecessor auditor. In addition to the communications described in paragraphs .07 through .10, the successor auditor



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should state that the purpose of the inquiries is to obtain information about whether to accept an engagement to perform a reaudit.

* * *

.16 The successor auditor should plan and perform the reaudit in accordance with the standards of the PCAOB. The successor auditor should not assume responsibility for the predecessor auditor's work or issue a report that reflects divided responsibility for that work as described in AS 1205~~6~~. Furthermore, the predecessor auditor is not a specialist as defined in AS 1210, *Using the Work of a Specialist*, nor does the predecessor auditor's work constitute the work of others as described in AS 2605, *Consideration of the Internal Audit Function*, or paragraphs .16–.19 of AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.

* * *

AS 2710 (currently AU sec. 550), *Other Information in Documents Containing Audited Financial Statements*

* * *

.04 Other information in a document may be relevant to an audit performed by an independent auditor or to the continuing propriety of his report. The auditor's responsibility with respect to information in a document does not extend beyond the financial information identified in his report, and the auditor has no obligation to perform any procedures to corroborate other information contained in a document. However, he should read the other information and consider whether such information, or the manner of its presentation, is materially inconsistent with information, or the manner of its presentation, appearing in the financial statements.² If the auditor concludes that there is a material inconsistency, he should determine whether the financial statements, his report, or both require revision. If he concludes that they do not require revision, he should request the client to revise the other information. If the other information is not revised to eliminate the material inconsistency, he should communicate the material inconsistency to the audit committee and consider other actions, such as revising his report to include an explanatory paragraph describing the material inconsistency, withholding the use of his report in the document, and withdrawing from the engagement. The action he takes will depend on the particular circumstances and the significance of the inconsistency in the other information.



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² In fulfilling his responsibility under this section, a ~~principal~~lead auditor may also request the other auditor or referred-to auditors ~~involved in the engagement~~ to read the other information. If a predecessor auditor's report appears in a document to which this section applies, he should read the other information for the reasons described in this paragraph. (See Appendix A of AS 2101, *Audit Planning*, for the definitions of lead auditor, other auditor, and referred-to auditor.)

* * *

AS 3101 (currently AU sec. 508), *Reports on Audited Financial Statements*

* * *

Explanatory Language Added to the Auditor's Standard Report

.11 Certain circumstances, while not affecting the auditor's unqualified opinion, may require that the auditor add an explanatory⁹ paragraph (or other explanatory language) to the standard report.¹⁰ These circumstances include:

- a. ~~The auditor's opinion is based in part on the report of another auditor (paragraphs .12 and .13)~~The auditor divides responsibility with, and makes reference in the auditor's report to the audit and report of, another accounting firm.^{10A}
- b. There is substantial doubt about the entity's ability to continue as a going concern.¹¹
- c. There has been a material change between periods in accounting principles or in the method of their application (paragraphs .17A through .17E).
- d. A material misstatement in previously issued financial statements has been corrected (paragraphs .18A through .18C).
- e. Certain circumstances relating to reports on comparative financial statements exist (paragraphs .68, .69, and .72 through .74).



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- f. Selected quarterly financial data required by SEC Regulation S-K has been omitted or has not been reviewed. (See paragraph .50 of AS 4105, *Reviews of Interim Financial Information*.)
- g. Supplementary information required by the Financial Accounting Standards Board (FASB), the Governmental Accounting Standards Board (GASB), or the Federal Accounting Standards Advisory Board (FASAB) has been omitted, the presentation of such information departs materially from FASB, GASB, or FASAB guidelines, the auditor is unable to complete prescribed procedures with respect to such information, or the auditor is unable to remove substantial doubts about whether the supplementary information conforms to FASB, GASB, or FASAB guidelines. (See paragraph .02 of AS 2705 (currently AU sec. 558), *Required Supplementary Information*.)
- h. Other information in a document containing audited financial statements is materially inconsistent with information appearing in the financial statements. (See paragraph .04 of AS 2710 (currently AU sec. 550), *Other Information in Documents Containing Audited Financial Statements*.)

In addition, the auditor may add an explanatory paragraph to emphasize a matter regarding the financial statements (paragraph .19).

⁹ Unless otherwise required by the provisions of this section, an explanatory paragraph may precede or follow the opinion paragraph in the auditor's report.

¹⁰ See footnote 3.

^{10A} AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*, establishes requirements for situations in which the auditor of the consolidated financial statements ("lead auditor") makes reference in the auditor's report to the report of another accounting firm that audited the financial statements of one or more of the company's business units ("referred-to auditor"). (See also paragraphs .B2 and .B3 of AS 2101, *Audit Planning*, which establish requirements regarding serving as the lead auditor.)

¹¹ AS 2415, *Consideration of an Entity's Ability to Continue as a Going Concern* (currently AU sec. 341, *The Auditor's Consideration of an Entity's Ability to*



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Continue as a Going Concern), describes the auditor's responsibility to evaluate whether there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time and, when applicable, to consider the adequacy of financial statement disclosure and to include an explanatory paragraph in the report to reflect his or her conclusions.

Opinion Based in Part on Report of Another Auditor
Dividing Responsibility for the Audit with the Referred-to Auditor

.12 When the auditor decides to make reference to the report of another auditor as a basis, in part, for his or her opinion, he or she should disclose this fact in the introductory paragraph of his or her report and should refer to the report of the other auditor in expressing his or her opinion. These references indicate division of responsibility for performance of the audit. (See AS 1205, *Part of the Audit Performed by Other Independent Auditors*.) When the lead auditor divides responsibility for the audit with the referred-to auditor, the lead auditor's report should make reference to the audit and report of the referred-to auditor in compliance with the requirements of AS 1206.08–.10.

.13 An example of a report indicating a division of responsibility follows:

Report of Independent Registered Public Accounting Firm

We have audited the consolidated balance sheets of ABC Company and subsidiaries as of December 31, 20X2 and 20X1, and the related consolidated statements of income, retained earnings, and cash flows for the years then ended. These 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 did not audit the financial statements of B Company, a wholly-owned subsidiary, which statements reflect total assets of \$_____ and \$_____ as of December 31, 20X2 and 20X1, respectively, and total revenues of \$_____ and \$_____ for the years then ended. Those statements were audited by other auditors 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 the other auditors.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance



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~~about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the report of other auditors provide a reasonable basis for our opinion.~~

~~In our opinion, based on our audits and the report of other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ABC Company and subsidiaries as of December 31, 20X2 and 20X1, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.~~

* * *

Reports on Comparative Financial Statements

* * *

Report of Predecessor Auditor

* * *

Predecessor Auditor's Report Reissued

.71 Before reissuing (or consenting to the reuse of) a report previously issued on the financial statements of a prior period, when those financial statements are to be presented on a comparative basis with audited financial statements of a subsequent period, a predecessor auditor should consider whether his or her previous report on those statements is still appropriate. Either the current form or manner of presentation of the financial statements of the prior period or one or more subsequent events might make a predecessor auditor's previous report inappropriate. Consequently, a predecessor auditor should (a) read the financial statements of the current period, (b) compare the prior-period financial statements that he or she reported on with the financial statements to be presented for comparative purposes, and (c) obtain representation letters from management of the former client and from the successor auditor. The representation letter from management of the former client should state (a)



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whether any information has come to management's attention that would cause them to believe that any of the previous representations should be modified, and (b) whether any events have occurred subsequent to the balance-sheet date of the latest prior-period financial statements reported on by the predecessor auditor that would require adjustment to or disclosure in those financial statements.²⁸ The representation letter from the successor auditor should state whether the successor's audit revealed any matters that, in the successor's opinion, might have a material effect on, or require disclosure in, the financial statements reported on by the predecessor auditor. Also, the predecessor auditor may wish to consider: ~~the matters described in AS 1205.10 through .12~~ (a) making inquiries about the professional reputation and standing of the successor auditor,^{28A} (b) obtaining a representation from the successor auditor that he or she is independent under the requirements of the PCAOB and the SEC, and (c) making inquiries of the successor auditor to determine that the successor auditor knows the relevant requirements of the applicable financial reporting framework, standards of the PCAOB, and financial reporting requirements of the SEC. However, the predecessor auditor should not refer in his or her reissued report to the report or work of the successor auditor.

²⁸ See AS 2805 (currently AU sec. 333), *Management Representations*, appendix C [paragraph .18], "Illustrative Updating Management Representation Letter."

^{28A} Inquiries may be made to one or more professional organizations or other relevant parties.

* * *

AS 3305 (currently AU sec. 623), *Special Reports*

* * *

Circumstances Requiring Explanatory Language in an Auditor's Special Report

.31 Certain circumstances, while not affecting the auditor's unqualified opinion, may require that the auditor add additional explanatory language to the special report. These circumstances include the following:

- a. *Lack of Consistency in Accounting Principles.* If there has been a change in accounting principles or in the method of their application,³⁵ the auditor



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should add an explanatory paragraph to the report (following the opinion paragraph) that describes the change and refers to the note to the financial presentation (or specified elements, accounts, or items thereof) that discusses the change and its effect thereon³⁶ if the accounting change is considered relevant to the presentation. Guidance on reporting in this situation is contained in AS 3101.16 through .18.

- b. *Going Concern Uncertainties.* If the auditor has substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time not to exceed one year beyond the date of the financial statement, the auditor should add an explanatory paragraph after the opinion paragraph of the report only if the auditor's substantial doubt is relevant to the presentation.³⁹
- c. ~~*Referred-to Other Auditors.* When the auditor decides to make reference to the report of another auditor as a basis, in part, for his or her opinion, the auditor should disclose that fact in the introductory paragraph of the report and should refer to the report of the other auditors in expressing his or her opinion. Guidance on reporting in this situation is contained in AS 3101.12 and .13 divides responsibility for the audit with another accounting firm, the auditor's report should make reference to the audit and report of the referred-to auditor in compliance with the requirements of paragraphs .08–.10 of AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm.*⁴⁰~~
- d. *Comparative Financial Statements (or Specified Elements, Accounts, or Items Thereof).* If the auditor expresses an opinion on prior-period financial statements (or specified elements, accounts, or items thereof) that is different from the opinion he or she previously expressed on that same information, the auditor should disclose all of the substantive reasons for the different opinion in a separate explanatory paragraph preceding the opinion paragraph of the report. Guidance on reporting in this situation is contained in AS 3101.68 and .69.

As in reports on financial statements prepared in conformity with generally accepted accounting principles, the auditor may add an explanatory paragraph to emphasize a matter regarding the financial statements (or specified elements, accounts, or items thereof).



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³⁵ When financial statements (or specified elements, accounts, or items thereof) have been prepared in conformity with generally accepted accounting principles in prior years, and the entity changes its method of presentation in the current year by preparing its financial statements in conformity with an other comprehensive basis of accounting, the auditor need not follow the reporting guidance in this subparagraph. However, the auditor may wish to add an explanatory paragraph to the report to highlight (1) a difference in the basis of presentation from that used in prior years or (2) that another report has been issued on the entity's financial statements prepared in conformity with another basis of presentation (for example, when cash basis financial statements are issued in addition to GAAP financial statements).

³⁶ A change in the tax law is not considered to be a change in accounting principle for which the auditor would need to add an explanatory paragraph, although disclosure may be necessary.

[^{37–38}] [Footnotes deleted.]

³⁹ See AS 2415, *Consideration of an Entity's Ability to Continue as a Going Concern*, for a report example when the auditor has substantial doubt about the entity's ability to continue as a going concern.

⁴⁰ AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*, establishes requirements for situations in which the auditor of the consolidated financial statements ("lead auditor") makes reference in the auditor's report to the report of another accounting firm that audited the financial statements of one or more of the company's business units. (See also paragraphs .B2 and .B3 of AS 2101, *Audit Planning*, which establish requirements regarding serving as the lead auditor.)

* * *



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AS 4105, *Reviews of Interim Financial Information* (currently AU sec. 722, *Interim Financial Information*)

* * *

Analytical Procedures, Inquiries, and Other Review Procedures

* * *

.18 *Inquiries and other review procedures.* The following are inquiries the accountant should make and other review procedures the accountant should perform when conducting a review of interim financial information:

- a. Reading the available minutes of meetings of stockholders, directors, and appropriate committees, and inquiring about matters dealt with at meetings for which minutes are not available, to identify matters that may affect the interim financial information.
- b. Obtaining reports from other accountants, if any, who have been engaged to perform a review of the interim financial information of significant components of the reporting entity, its subsidiaries, or its other investees, or inquiring of those accountants if reports have not been issued.¹¹
- c. Inquiring of members of management who have responsibility for financial and accounting matters concerning:
 - Whether the interim financial information has been prepared in conformity with generally accepted accounting principles consistently applied.
 - Unusual or complex situations that may have an effect on the interim financial information. (See Appendix B [paragraph .55] of this section for examples of unusual or complex situations about which the accountant ordinarily would inquire of management.)
 - Significant transactions occurring or recognized in the last several days of the interim period.



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- The status of uncorrected misstatements identified during the previous audit and interim review (that is, whether adjustments had been recorded subsequent to the prior audit or interim period and, if so, the amounts recorded and period in which such adjustments were recorded).
 - Matters about which questions have arisen in the course of applying the review procedures.
 - Events subsequent to the date of the interim financial information that could have a material effect on the presentation of such information.
 - Their knowledge of any fraud or suspected fraud affecting the entity involving (1) management, (2) employees who have significant roles in internal control, or (3) others where the fraud could have a material effect on the financial statements.
 - Whether they are aware of allegations of fraud or suspected fraud affecting the entity, for example, received in communications from employees, former employees, analysts, regulators, short sellers, or others.
 - Significant journal entries and other adjustments.
 - Communications from regulatory agencies.
 - Significant deficiencies, including material weaknesses, in the design or operation of internal controls which could adversely affect the issuer's ability to record, process, summarize, and report financial data.
- d. Obtaining evidence that the interim financial information agrees or reconciles with the accounting records. For example, the accountant may compare the interim financial information to (1) the accounting records, such as the general ledger; (2) a consolidating schedule derived from the accounting records; or (3) other supporting data in the entity's records. In addition, the accountant should consider inquiring of management as to the reliability of the records to which the interim financial information was compared or reconciled.



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- e. Reading the interim financial information to consider whether, based on the results of the review procedures performed and other information that has come to the accountant's attention, the information to be reported conforms with generally accepted accounting principles.
- f. Reading other information that accompanies the interim financial information and is contained in reports (1) to holders of securities or beneficial interests or (2) filed with regulatory authorities under the Securities Exchange Act of 1934 (such as Form 10-Q or 10-QSB), to consider whether such information or the manner of its presentation is materially inconsistent with the interim financial information.¹² If the accountant concludes that there is a material inconsistency, or becomes aware of information that he or she believes is a material misstatement of fact, the action taken will depend on his or her judgment in the particular circumstances. In determining the appropriate course of action, the accountant should consider the guidance in paragraphs .04 through .06 of AS 2710, *Other Information in Documents Containing Audited Financial Statements*.
- g. Evaluating management's quarterly certifications about internal control over financial reporting by performing the following procedures —
 - Inquiring of management about significant changes in the design or operation of internal control over financial reporting as it relates to the preparation of annual as well as interim financial information that could have occurred subsequent to the preceding annual audit or prior review of interim financial information;
 - Evaluating the implications of misstatements identified by the auditor as part of the auditor's other interim review procedures as they relate to effective internal control over financial reporting; and
 - Determining, through a combination of observation and inquiry, whether any change in internal control over financial reporting has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting.



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¹¹ In these circumstances, the accountant ordinarily is in a position similar to that of the lead auditor. ~~(See paragraphs .B2 and .B3 of AS 2101, *Audit Planning*, which establish requirements regarding serving as the lead auditor.) an auditor who acts as principal auditor (see AS 1205, *Part of the Audit Performed by Other Independent Auditors*) and makes use of the work or reports of other auditors in the course of an audit of financial statements.~~

¹² The principal accountant also may request other accountants involved in the engagement, if any, to read the other information.

* * *

The Accountant's Report on a Review of Interim Financial Information²⁴

Form of Accountant's Review Report

²⁴ Paragraphs .37 through .46 of this section provide reporting guidance for a review of interim financial information; however, an accountant is not required to issue a report on such engagements.

* * *

.39 An accountant may be engaged to report on a review of comparative interim financial information. The following is an example of a review report on a condensed balance sheet as of March 31, 20X1, the related condensed statements of income and cash flows for the three-month periods ended March 31, 20X1 and 20X0, and a condensed balance sheet derived from audited financial statements as of December 31, 20X0, that were included in Form 10-Q.²⁷

Report of Independent Registered Public Accounting Firm

We have reviewed the condensed consolidated balance sheet of ABC Company and subsidiaries as of March 31, 20X1, and the related condensed consolidated statements of income and cash flows for the three-month periods ended March 31, 20X1 and 20X0. These financial statements are the responsibility of the company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and



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making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the condensed financial statements referred to above for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board, the consolidated balance sheet of ABC Company and subsidiaries as of December 31, 20X0, and the related consolidated statements of income, retained earnings, and cash flows for the year then ended (not presented herein); and in our report dated February 15, 20X1, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 20X0, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.²⁸

[*Signature*]

[*City and State or Country*]

[*Date*]

²⁷ Regulation S-X specifies that the following financial information should be provided in filings on Form 10-Q:

- a. An interim balance sheet as of the end of the most recent fiscal quarter and a balance sheet as of the end of the preceding fiscal year that may be condensed to the same extent as the interim balance sheet.
- b. Interim condensed statements of income for the most recent fiscal quarter, for the period between the end of the preceding fiscal year and the end of the most recent fiscal quarter, and for the corresponding periods of the preceding fiscal year.



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- c. Interim condensed cash flow statements for the period between the end of the preceding fiscal year and the end of the most recent fiscal quarter and for the corresponding period for the preceding fiscal year.

²⁸ If the auditor's report on the preceding year-end financial statements was other than unqualified, ~~referred to other auditors~~ made reference to an audit and auditor's report of another accounting firm, or included an explanatory paragraph because of a going-concern matter or an inconsistency in the application of accounting principles, the last paragraph of the illustrative report in paragraph .39 should be appropriately modified.

.40 The accountant may use and make reference to another accountant's review report on the interim financial information of a significant component of a reporting entity. This reference indicates a division of responsibility for performing the review.²⁹ The following is an example of report including such a reference:

Report of Independent Registered Public Accounting Firm

We have reviewed the accompanying [*describe the interim financial information or statements reviewed*] of ABC Company and consolidated subsidiaries as of September 30, 20X1, and for the three-month and nine-month periods then ended. This (These) interim financial information (statements) is (are) the responsibility of the company's management.

We were furnished with the report of other accountants on their review of the interim financial information of DEF subsidiary, whose total assets as of September 30, 20X1, and whose revenues for the three-month and nine-month periods then ended, constituted 15 percent, 20 percent, and 22 percent, respectively, of the related consolidated totals.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information (statements) consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the



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financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review and the report of other accountants, we are not aware of any material modifications that should be made to the accompanying interim financial information (statements) for it (them) to be in conformity with accounting principles generally accepted in the United States of America.

[Signature]

[City and State or Country]

[Date]

²⁹ See AS 1205~~6~~, Dividing Responsibility for the Audit with Another Accounting Firm.

* * *

AS 6115 (currently Auditing Standard No. 4), *Reporting on Whether a Previously Reported Material Weakness Continues to Exist*

* * *

Planning the Engagement

.24 The auditor should properly plan the engagement to report on whether a previously reported material weakness continues to exist and should properly supervise engagement team members~~any~~—assistants. When planning the engagement, the auditor should evaluate how the matters described in AS 2201.09 will affect the auditor's procedures.

* * *

Opinions, Based in Part, on the Work of Another Auditor Engagements Involving Other Accounting Firms

.40 The auditor may apply the relevant concepts in AS 1205, Part of the Audit Performed by Other Independent Auditors, in if an engagement to report on whether a previously reported material weakness continues to exist involves another accounting



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~~firm, the lead, with the following exception. If the auditor decides to serve as the principal auditor and to use the work and reports of another auditor as a basis, in part, for his or her opinion, the principal auditor must not divide responsibility for the engagement with the other auditor accounting firm. Therefore, the principal auditor must not make reference to the other auditor in his or her report.~~

* * *

Rule 1001. *Definitions of Terms Employed in Rules*

When used in the Rules, unless the context otherwise requires:

* * *

(p)(ii) Play a Substantial Role in the Preparation or Furnishing of an Audit Report

The phrase "play a substantial role in the preparation or furnishing of an audit report" means –

- (1) to perform material services that a public accounting firm uses or relies on in issuing all or part of its audit report, or
- (2) to perform the majority of the audit procedures with respect to a subsidiary or component of any issuer, broker, or dealer, the assets or revenues of which constitute 20% or more of the consolidated assets or revenues of such issuer, broker, or dealer necessary for the ~~principal~~ lead auditor to issue an audit report.

Note 1: For purposes of paragraph (1) of this definition, the term "material services" means services, for which the engagement hours or fees constitute 20% or more of the total engagement hours or fees, respectively, provided by the ~~principal~~ lead auditor in connection with the issuance of all or part of its audit report. The term does not include non-audit services provided to non-audit clients.

Note 2: For purposes of paragraph (2) of this definition, the phrase "subsidiary or component" is meant to include any subsidiary, division, branch, office or other component of an issuer, broker, or dealer, regardless of its form of organization and/or control relationship with the issuer, broker, or dealer.



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Note 3: For purposes of determining "20% or more of the consolidated assets or revenues" under paragraph (2) of this Rule, this determination should be made at the beginning of the issuer's, broker's, or dealer's fiscal year using prior year information and should be made only once during the issuer's, broker's, or dealer's fiscal year.



APPENDIX 4

Additional Discussion of Proposed Amendments and Proposed New Standard

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I. Introduction

This proposal is intended to improve the quality of audits that involve firms and accountants outside the accounting firm issuing the audit report (collectively "other auditors"). This appendix discusses in more detail amendments to existing auditing standards and a new auditing standard proposed by the Public Company Accounting Oversight Board ("PCAOB" or "Board") relating to the use of other auditors and dividing responsibility for the audit with another accounting firm ("proposal" or "Board's proposal").

In brief, the Board's proposal includes:

- Proposed amendments to AS 1201 (currently Auditing Standard No. 10), *Supervision of the Audit Engagement*,¹ AS 2101 (currently Auditing

¹ In 2015, the PCAOB adopted and the U.S. Securities and Exchange Commission ("SEC") approved the reorganization of PCAOB auditing standards using a topical structure and a single, integrated numbering system. See *Reorganization of PCAOB Auditing Standards and Related Amendments to PCAOB Standards and Rules*,



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Standard No. 9), *Audit Planning*, AS 1220 (currently Auditing Standard No. 7), *Engagement Quality Review*, and AS 1215 (currently Auditing Standard No. 3), *Audit Documentation*, ("proposed amendments"), which are included in Appendix 1 of this release; and

- Proposed new auditing standard, AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*, for situations in which the accounting firm issuing the audit report divides responsibility for the audit with another accounting firm.

In general, this proposal (1) retains the existing approach under PCAOB standards for the relatively infrequent situations in which the lead auditor divides responsibility with another auditor and (2) extends the existing risk-based approach to supervision to apply to all other situations in which firms and accountants outside the accounting firm issuing the audit report participate in an audit. Both the proposed standard and the proposed amendments contain improved requirements and additional direction that sets forth the responsibilities of the lead auditor, the auditor issuing the auditor's report, in these situations. For example, the proposal would require the lead auditor to, among other things, supervise the work of other auditors pursuant to AS 1201, as amended by the proposal, unless the lead auditor divides responsibility for the audit with another auditor.

A. Comparison with Standards of the International Auditing and Assurance Standards Board and the Auditing Standards Board

This appendix also includes a comparison of this proposal with the analogous requirements of the following standards issued by the International Auditing and Assurance Standards Board ("IAASB") and the Auditing Standards Board ("ASB") of the American Institute of Certified Public Accountants ("AICPA"). The following IAASB and ASB standards are included in the comparison:

PCAOB Release No. 2015-002 (Mar. 31, 2015); SEC, *Public Company Accounting Oversight Board; Order Granting Approval of Proposed Rules To Implement the Reorganization of PCAOB Auditing Standards and Related Changes to PCAOB Rules and Attestation, Quality Control, and Ethics and Independence Standards*, Exchange Act Release No. 75935 (Sept. 17, 2015), 80 FR 57263 (Sept. 22, 2015). The reorganized amendments will be effective as of December 31, 2016, but may be used and referenced before that date. See PCAOB Release No. 2015-002, at 21.



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IAASB Standards

- International Standard on Auditing 220, *Quality Control for an Audit of Financial Statements* ("ISA 220");
- International Standard on Auditing 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* ("ISA 600"); and
- International Standard on Quality Control 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements* ("ISQC 1").

ASB Standards

- AU-C Section 220, *Quality Control for an Engagement Conducted in Accordance with Generally Accepted Auditing Standards* ("AU-C Section 220");
- AU-C Section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* ("AU-C Section 600"); and
- AICPA, Statement on Quality Control Standards No. 8, *A Firm's System of Quality Control (Redrafted)* ("SQCS No. 8").

The comparison included in the appendix may not represent the views of the IAASB or ASB regarding the interpretation of their standards. The information presented in this appendix does not cover the application and explanatory material in the IAASB standards or ASB standards.²

² Paragraph A59 of ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, indicates that the application and other explanatory material section of the ISAs "does not in itself impose a requirement" but "is relevant to the proper application of the requirements of an ISA." Paragraph .A64 of AU-C Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Generally Accepted Auditing Standards*, states that, although application and other explanatory



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Importantly, ISA 600 and AU-C 600 employ a different approach from the Board's proposal. ISA 600 and AU-C 600 set forth requirements for "group audits" performed by a "group engagement team" and "component auditors." Group audits are audits of "group financial statements" consisting of at least two "components." Group audits seemingly are designed for an audit engagement team organized around the financial reporting structures of companies with multiple financial reporting units. Group audits can be performed by a single firm or multiple firms. Also, ISA 600 and AU-C 600 address other matters such as multi-location scoping that are already addressed in existing PCAOB standards.³

In contrast, this proposal applies to all audit engagements involving other auditors, regardless of the company's financial reporting structure, and this proposal focuses on the lead auditor's responsibilities with respect to involvement with the other auditors.

B. Requests for Comment

The Board requests comments on specific questions that are included in this appendix, as well as on the proposal in general.

II. Terminology – Proposed Definitions

To operationalize the proposed requirements, this proposal includes proposed definitions of "engagement team," "lead auditor," "other auditor," and "referred-to auditor."

material "does not in itself impose a requirement, it is relevant to the proper application of the requirements of an AU-C section."

³ See, e.g., AS 2101.11–.14, paragraph .10 of AS 2105, (currently Auditing Standard No. 11), *Consideration of Materiality in Planning and Performing an Audit*, and paragraphs .33 and .B10–.B16 of AS 2201 (currently Auditing Standard No. 5), *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.



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A. Proposed Definition of "Engagement Team"

See proposed paragraph .A3 of AS 1201 and AS 2101 in Appendix 1

According to existing PCAOB standards, the engagement partner is responsible for proper supervision of the work of engagement team members.⁴ The term "engagement team" is used in existing PCAOB auditing standards but is not expressly defined. The proposed definition of "engagement team" would specify the persons subject to supervision under AS 1201, extending the range of supervision to cover other auditors for whose work the lead auditor currently assumes responsibility under AS 1205.

Specifically, the proposed definition of "engagement team" would include: (1) partners, principals, and shareholders of, and accountants⁵ 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.

The proposed definition of "engagement team" would *not* include: (1) the engagement quality reviewer and those assisting the reviewer (to which AS 1220 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 proposed AS 1206, or (3) engaged specialists.⁶

The following are examples of individuals who would be considered members of the engagement team under the Board's proposal:

- Personnel of accounting firms other than the lead auditor and individual accountants outside the lead auditor's firm (engaged directly or through

⁴ See AS 1201.03.

⁵ See paragraph (a)(ii) in PCAOB Rule 1001, *Definitions of Terms Employed in Rules*.

⁶ See AS 1210 (currently AU sec. 336), *Using the Work of a Specialist*.



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other accounting firms, consulting firms, or temporary workforce agencies) whose work the lead auditor currently supervises under AS 1201.

- Personnel of accounting firms described in AS 1205 (currently AU sec. 543), *Part of the Audit Performed by Other Independent Auditors*, (which would be superseded by the proposal) as other auditors for whose work the principal auditor (current AS 1205 term) assumes responsibility.

By including these individuals in the engagement team, the proposal would expand the lead auditor's responsibility to apply the risk-based supervision approach to all accounting firms, except in situations in which the lead auditor divides responsibility for the audit with another accounting firm. (If the lead auditor divides responsibility for the audit with an accounting firm, that firm would be considered a referred-to auditor under proposed AS 1206.)

- An individual from a firm's national office who performs audit procedures on the audit.

For example, if an individual from the national office is seconded to the engagement team to obtain an understanding of the methods and assumptions used by a specialist in the valuation of securities held by the company, he or she would be considered a member of the engagement team.

The following are examples of individuals who would not be considered members of the engagement team under the Board's proposal:

- Engagement quality reviewer and those assisting the reviewer, to which AS 1220 applies.⁷

⁷ In some situations, individuals from U.S. accounting firms, including from their national offices, review the work of non-U.S. accounting firms in accordance with one of the Board's quality control standards, known as Appendix K. See SEC Practice Section ("SECPS") Section 1000.45 Appendix K, *SECPS Member Firms With Foreign Associated Firms That Audit SEC Registrants*. The Board adopted Appendix K as part of its interim standards. See Rule 3400T(b), *Interim Quality Control Standards*, SECPS Section 1000.08(n). Appendix K requires accounting firms associated with international



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- Specialists engaged by the auditor. The Board's proposal would not change the requirement that the auditor apply AS 1210, when using the work of engaged specialists in fields other than accounting or auditing.⁸
- Service auditors who issue reports on the controls of a service organization and whose report is used by the engagement team to support the auditor's opinion as described in AS 2601, *Consideration of an Entity's Use of a Service Organization* (currently AU sec. 324, *Service Organizations*).
- An individual from a firm's national office who provides a consultation on the audit, but does not perform audit procedures or supervise the work of the audit.
- Individuals employed or engaged, directly or indirectly, by the company being audited. Such individuals may include, for example, the company's internal auditors, company's specialists, company's consultants, or others. Because of their roles at the company, the work of individuals employed or engaged by the company is not subject to supervision under AS 1201; they would not be considered members of the engagement team under the proposal. Existing PCAOB standards include requirements regarding the auditor's use of work performed by some of these individuals.⁹

firms to seek the adoption of policies and procedures consistent with certain objectives, including having policies and procedures for certain filings of SEC registrants which are the clients of foreign associated firms to be reviewed by persons knowledgeable in PCAOB standards. Because Appendix K reviewers do not make decisions on behalf of the engagement team or assume any of the responsibilities of the engagement team, similar to the engagement quality reviewer, the reviewers would not be considered members of the engagement team.

⁸ The Board has a separate standard-setting project regarding specialists, which could result in changes to the auditor's responsibilities regarding the auditor's use of the work of specialists and, in turn, could result in changes to AS 1201 as well as other standards.

⁹ See, e.g., AS 2605, *Consideration of the Internal Audit Function* (currently AU sec. 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*), or paragraphs .16–.19 of AS 2201 (currently Auditing Standard



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Neither the proposed definition of "engagement team" nor any of the amendments in this proposal would affect the applicability of the independence and ethics requirements of the Board or the SEC to audits involving other auditors. While the proposed amendments would include certain individuals in, or exclude certain other individuals from, the definition of engagement team in PCAOB standards, the Board's proposal would not change the applicability or the meaning of engagement team in the context of the PCAOB's or SEC's independence rules.¹⁰

B. Proposed Definition of "Lead Auditor"

See proposed paragraph .A4 of AS 1201 and AS 2101 and proposed paragraph .A2 of the Proposed New Standard AS 1206

The proposal introduces the term "lead auditor" for supervising other auditors under AS 1201 and dividing responsibility under proposed AS 1206. Under the proposal, the term "lead auditor" applies to the firm issuing the auditor's report or supervisory personnel from that firm, depending on the context.

Specifically, the term "lead auditor" would be defined as follows:

Lead auditor –

(a) The registered public accounting firm¹¹ 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:

No. 5), *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.

¹⁰ For example, the individuals covered by the Board's proposed definition of "engagement team" are also covered by the definition of "audit engagement team" in the SEC's independence rules. See Rule 2-01(f)(7)(i) of Regulation S-X, 17 CFR 210.2-01(f)(7)(i). The definition in SEC Rule 2-01(f)(7)(i) also covers certain individuals who are not covered by the Board's proposed definition of "engagement team," such as the engagement quality reviewer.

¹¹ See paragraph (r)(i) in PCAOB Rule 1001, *Definitions of Terms Employed in Rules*, which defines the term "registered public accounting firm."



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(i) are partners, principals, shareholders, or employees of the registered public accounting firm issuing the auditor's report and

(ii) assist the engagement partner in fulfilling his or her planning or supervisory responsibilities on the audit pursuant to AS 2101 or AS 1201.¹²

The proposed definition is consistent with the concept in existing PCAOB standards,¹³ that the engagement partner may seek assistance from other engagement team members in fulfilling his or her planning and supervisory responsibilities.

As with any assigned responsibility on an audit, the engagement partner should seek planning or supervisory assistance only from engagement team members with the necessary knowledge, skill, and ability, and that would apply to those assisting in the supervision of other auditors.¹⁴ This includes, for example, sufficient knowledge of a particular industry to assist the engagement partner in supervising the other auditor's work at a company's operations in that industry.

C. Proposed Definitions of "Other Auditor" and "Referred-to Auditor"

See proposed paragraph .A5 of AS 1201 and AS 2101 for the term "other auditor" and proposed paragraph .A6 of AS 2101 and .A3 of the Proposed New Standard AS 1206 for the term "referred-to auditor"

Currently several PCAOB standards use the term "other auditor" to encompass any other auditors that participate in an audit, regardless of whether the lead auditor supervises them under AS 1201, assumes responsibility under AS 1205, or

¹² See paragraph .05a of AS 2301 (currently Auditing Standard No. 13), *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 (currently AU sec. 230), *Due Professional Care in the Performance of Work* according to which "[a]uditors should be assigned to tasks and supervised commensurate with their level of knowledge, skill, and ability."

¹³ See, e.g., AS 1201.04 and AS 2101.03.

¹⁴ See, e.g., AS 2301.05a and AS 1015.06.



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makes reference to them under AS 1205.¹⁵ But existing PCAOB standards do not define the term "other auditor." This proposal adopts two definitions: "other auditor," which applies to those supervised under AS 1201, as proposed to be amended, and "referred-to auditor," which applies when the lead auditor divides responsibility.

The proposed definitions are:

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.

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 units¹⁶ 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.

The "other auditor" definition encompasses both the individuals participating in the audit and their firm. In contrast, the referred-to auditor definition applies only to the firm because the firm issues an auditor's report in the divided responsibility situation.

D. Comparison with Standards of Other Standard Setters

ISA 600 uses the terms "group engagement team" and "component auditor" as follows:

Group engagement team – Partners, including the group engagement partner, and staff who establish the overall group audit strategy, communicate with component auditors, perform work on the consolidation process, and evaluate

¹⁵ For example, AS 1205 uses this term to describe accounting firms whose work the lead auditor uses or with which it divides responsibility for the audit; AS 1215.18 and .19 use the term "other auditor" when describing offices of the firm issuing the audit report and other firms participating in the audit.

¹⁶ The term "business units" includes subsidiaries, divisions, branches, components, or investments.



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the conclusions drawn from the audit evidence as the basis for forming an opinion on the group financial statements; and

Component auditor – An auditor who, at the request of the group engagement team, performs work on financial information related to a component for the group audit.

In contrast, other IAASB standards use the term "engagement team." For example, paragraph 7 of ISA 220 provides the following definition:

Engagement team – All partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform audit procedures on the engagement. This excludes an auditor's external expert engaged by the firm or a network firm.

IAASB standards do not contain requirements for situations in which the auditor divides responsibility for the audit with another independent public accounting firm.

AU-C Section 600 has the same definition for the group engagement team. Under AU-C Section 600, component auditor is defined as follows:

Component auditor – An auditor who performs work on the financial information of a component that will be used as audit evidence for the group audit. A component auditor may be part of the group engagement partner's firm, a network firm of the group engagement partner's firm, or another firm.

Similar to the IAASB standards, other ASB standards use the term "engagement team." For example, AU-C Section 220 defines the term the same as defined in ISA 220.

ASB standards include requirements for situations in which the auditor divides responsibility for the audit with another independent public accounting firm. Unlike proposed AS 1206, ASB standards do not include a specific term analogous to the proposed term "referred-to auditor" to distinguish from other component auditors an accounting firm with which the auditor divides responsibility for the audit.

Questions:

16. Are the proposed definitions of: (a) "engagement team," (b) "lead auditor," (c) "other auditor," and (d) "referred-to auditor" appropriate? Do the



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proposed definitions clearly describe individuals and entities that are included in these definitions? Is it clear which individuals or entities are not included in these definitions? If not, what changes to the proposed definitions are necessary?

17. Some global network firms use short-term (several months) personnel sharing arrangements, during which some available personnel are seconded to other firms and function as their employees. Some firms contract with consulting firms or temporary workforce agencies for personnel that work alongside and in the same capacity as personnel on the engagement team that are employed by the lead auditor. Should these personnel be treated as part of the lead auditor?
18. Are there any situations in practice where applying the new definitions of "engagement team" and "other auditor," including related requirements, would present practical challenges?
19. Should there be requirements for the lead auditor to: (1) specifically identify the engagement team members responsible for assisting the engagement partner of the lead auditor in fulfilling his or her supervisory responsibilities and (2) document such assignments? Should the individuals who assist the engagement partner with supervision be limited to engagement team members from the office issuing the auditor's report?
20. To emphasize the importance of assigning the proposed planning and supervision requirements to personnel with the appropriate qualifications in audits involving other auditors, the proposed definition of "lead auditor" references existing standards that describe making appropriate assignments of engagement responsibilities. Does this reference appropriately address the responsibility to seek planning and supervision assistance from qualified engagement team members in these situations?



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III. Proposed Amendments to AS 2101

The proposal includes a number of amendments to the standard for audit planning, AS 2101. In general, these amendments either retain and update requirements from AS 1205, which is proposed to be superseded, or amend existing requirements to specify that they be performed by the lead auditor. These amendments primarily relate to:

- Determining the sufficiency of a firm's participation to serve as lead auditor in an audit that involves other auditors or referred-to auditors;
- Determining locations and business units at which audit procedures should be performed in an audit that involves other auditors or referred-to auditors;
- Determining compliance of other auditors with SEC and PCAOB independence and ethics requirements;
- Determining registration status of other auditors that play a "substantial role" on an audit; and
- Understanding the qualifications of other auditors and determining the lead auditor's ability to communicate with other auditors.

This section of the appendix discusses proposed planning requirements for audits in which the lead auditor supervises the work of other auditors in accordance with AS 1201 and certain proposed planning requirements included in AS 2101 for audits in which the lead auditor divides responsibility for the audit with referred-to auditors in accordance with proposed AS 1206.¹⁷

¹⁷ In addition, Section VII of this appendix discusses, among other things, requirements for the lead auditor in proposed AS 1206 relating to the referred-to auditor's (1) compliance with the SEC and PCAOB independence and ethics requirements, (2) registration pursuant to the rules of the PCAOB, and (3) knowledge of the relevant accounting, auditing, and financial reporting requirements.



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A. Determining the Sufficiency of a Firm's Participation to Serve as Lead Auditor in an Audit that Involves Other Auditors or Referred-to Auditors

See proposed paragraph .B2 of AS 2101

Currently, in situations governed by AS 1205, when significant parts of the audit are performed by "other auditors" or "referred-to auditors" (as these terms are defined by the proposal), the lead auditor must decide whether the auditor's own participation is sufficient to enable the auditor to issue the auditor's report on the company's financial statements.¹⁸ This proposal would retain the requirement to determine sufficiency of participation as part of audit planning and revise it as described below.

Under existing AS 1205, when making this decision, the auditor is required to consider, among other things, (i) the materiality of the portion of the financial statements audited in comparison with the portion audited by other auditors; (ii) the extent of the auditor's knowledge of the overall financial statements; and (iii) the importance of the components audited by the auditor in relation to the enterprise as a whole.

The proposal would revise the requirement to determine the sufficiency of participation by (i) extending the required determination to apply to all audits involving other auditors and referred-to auditors (not just those covered by AS 1205 today); (ii) imposing the determination requirement specifically on the engagement partner; and (iii) requiring that the determination be based on the risks of material misstatement associated with the portions of the financial statements audited by the engagement partner's firm relative to the portion audited by the other auditors.

Extending the sufficiency of participation determination to all audits involving other auditors and referred-to auditors and imposing the determination requirement on the engagement partner is 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.

The proposed determination would be based on the risks of material misstatement associated with the portion of the company's financial statements audited by the engagement partner's firm (including the portion's materiality) in comparison with the portions for which the other auditors perform audit procedures or the portions

¹⁸ See AS 1205.02.



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audited by the referred-to auditors. Describing a sufficiency of participation criterion in terms of risk, rather than "importance" as in AS 1205, would be more consistent with the requirements in PCAOB standards for determining the scope of audit work in a multi-location engagement.¹⁹ The proposed risk-based criterion is intended to capture both quantitative as well as qualitative characteristics of a particular scenario.²⁰ Under this criterion, the lead auditor ordinarily would need to audit the location at which the primary financial reporting decisions were made and the consolidated financial statements were prepared in order to address the risks related to those important judgments and activities, and a sufficient number of other locations to cover a greater portion of the risks than any of the other audit firms performing procedures on the audit.

Because planning is not a discrete phase of an audit, but is instead a continual and iterative process,²¹ the engagement partner is expected to revisit his or her determination of the sufficiency of the lead auditor's participation throughout the course of the audit if circumstances change. This may happen, for example, if the lead auditor assigns more responsibilities to another accounting firm than originally planned, or if the company acquires another company that is audited by another accounting firm after the initial decisions are made, or if the risk profile changes due to other unforeseen events.

The following are examples of possible applications of the proposed requirements in hypothetical situations, which are similar to situations observed in the Board's oversight activities. These examples have been provided for illustrative purposes only. Similar situations in practice accompanied by additional information could lead to different conclusions. Accounting firms described in the examples may be from the same network of firms as the lead auditor, different networks, or unaffiliated with any such network.

Example 1—A multinational company with locations or business units in more than 100 countries has its global headquarters in Country A. The headquarters include the offices of the chief executive officer ("CEO"), chief financial officer ("CFO"), and controller, who are responsible for key operational, financial, and reporting decisions and for significant management judgments that are necessary for preparing the company's consolidated financial statements.

¹⁹ See, e.g., AS 2101.11–.14.

²⁰ See also the discussion of key policy choices related to the determination of sufficiency of participation in Section IV.D.3(i) of this release at 47.

²¹ See AS 2101.05.



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Approximately one-third of the company's worldwide operations (revenues and assets) are in Country A. The chairman of the board and several of the company's senior executives work in Country B. However, only five percent of the company's worldwide operations are in Country B.

Accounting Firm 1 is located in Country A and performs audit procedures with respect to the company's global headquarters and operations in Country A. Accounting Firm 2 is located in Country B and performs audit procedures with respect to the company's operations in Country B. Other firms perform audit procedures with respect to the company's operations in other countries, none of which represents more than 10 percent of the company's operations. The identified risks of material misstatement to the consolidated financial statements which are associated with the company's operations in Country A are greater than in Country B or other countries, in part, because key operational, financial, and reporting decisions and significant management judgments are made by executives located in Country A.

Under the proposal, the participation of Accounting Firm 1 would be sufficient for the firm to carry out the responsibilities of a lead auditor and to report as such on the company's financial statements. Greater risks of material misstatement are associated with the portion of the company's operations audited by Accounting Firm 1 than with portions audited by the other auditors. The company's revenue and assets audited by Accounting Firm 1 are the largest portion of revenue and assets in comparison with the remaining individual portions audited by the other auditors or referred-to auditors.

Despite the fact that Accounting Firm 2 performs audit procedures with respect to the company's operations in Country B in which the chairman of the board and several of the company's senior executives work, the participation of this firm would not be sufficient to serve as the lead auditor because greater risks of material misstatement are associated with the portion of financial statements audited by Accounting Firm 1 than with the portion audited by Accounting Firm 2.

Example 2—A multinational company operates in eight countries and its global headquarters are located in Country A. The headquarters include the offices of the CEO, CFO, and controller, who are responsible for key financial and reporting decisions, including the significant management judgments necessary to prepare the company's financial statements, such as selection of accounting policies and important asset and liability valuations. Additionally, the



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headquarters location is responsible for the consolidation and preparation of the company's financial statements. Headquarters personnel also execute all significant financing and investing activities and determine the accounting for those activities, even significant assets owned by and recorded in the financial statements of a country subsidiary. The company's operations in Country A contribute only 10 percent of consolidated revenue, however.

The company's activities in the other countries consist of routine sales and operating activities, which involve no significant accounting judgments. Those activities have not significantly changed over the past several years.

Accounting Firm 1, located in Country A, performs audit procedures with respect to Country A, which represents 10 percent of worldwide revenue and includes the company's headquarters. For company operations in the other countries, the largest of which represent 15, 18, and 20 percent of the worldwide revenue, audit procedures are performed by an accounting firm located in the respective country.

Under the proposal, the participation of Accounting Firm 1 would be sufficient to carry out the responsibilities of a lead auditor and to report as such on the company's consolidated financial statements. Accounting Firm 1 performs audit procedures with respect to the location that poses the greatest risk of material misstatement to the consolidated financial statements, including the risks related to the consolidation and financial statement preparation, significant accounting judgments, and complex accounting issues. Thus, although other accounting firms might perform audit procedures with respect to larger portions of the company's worldwide revenue than Accounting Firm 1, the risks of material misstatement associated with the portion of the company's financial statements audited by Accounting Firm 1 are relatively greater than the risk at the other individual locations. If the locations in the other countries had more complex operations with higher risks of material misstatement, Accounting Firm 1 would likely need to cover one or more other locations in addition to Country A in order to satisfy the sufficiency criteria in the proposal.

Example 3—A company located in Country A plans to hire Accounting Firm 1 located in Country B to perform an audit of, and issue the audit report on, the company's financial statements. The engagement partner and audit manager with Accounting Firm 1 plan to use Accounting Firm 2, which is located in Country A, to perform audit procedures on company's principal operations in



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Country A that would constitute substantially all of the audit procedures on the company's financial statements.

Under the proposal, despite the fact that the engagement partner and manager are with Accounting Firm 1, the participation of Accounting Firm 1 in the audit would not be sufficient to serve as the lead auditor because substantially all of the audit procedures on the company's financial statements would be performed by another firm. The conclusion would be the same if Accounting Firms 1 and 2 were in the same network of firms or if the engagement partner and audit manager (who are from Country B) were in Country A for the duration of the audit. The Board's proposal is not intended to provide a way for an auditor to take responsibility for the work of another auditor that has essentially audited a company's financial statements in their entirety.

Comparison with Standards of Other Standard Setters

Paragraph 8a of ISA 600 states that an objective of the auditor is to determine whether to act as the auditor of the group financial statements. Paragraph 12 of ISA 600 states, among other things, that where component auditors will perform work on the financial information of such components, the group engagement partner shall evaluate whether the group engagement team will be able to be involved in the work of those component auditors to the extent necessary to obtain sufficient appropriate audit evidence. Paragraph 13 of ISA 600 includes requirements for situations in which the group engagement partner concludes that it will not be possible for the group engagement team to obtain sufficient appropriate audit evidence due to restrictions imposed by group management; and the possible effect of this inability will result in a disclaimer of opinion on the group financial statements. ISA 220 requires that the engagement partner take responsibility for the direction, supervision, performance, and review of the audit engagement and for being satisfied that sufficient appropriate audit evidence has been obtained on which to base the auditor's opinion on the financial statements.²²

AU-C Section 600 contains requirements that are similar to those in ISA 600.

²² See paragraphs 15–17 of ISA 220.



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B. Determining Locations and Business Units at Which Audit Procedures Should Be Performed in an Audit that Involves Other Auditors or Referred-to Auditors

See proposed amendments to paragraph .14 of AS 2101

Other auditors are often involved in audits of companies with operations in multiple locations and business units ("multi-location engagements"). Some of the existing requirements for such audits in PCAOB standards differ depending on whether AS 1201 or AS 1205 applies, as follows:

- In situations governed by AS 1201, paragraph .11 of AS 2101 requires determining (i) the locations at which audit procedures should be performed and (ii) the nature, timing, and extent of the procedures.
- In situations governed by AS 1205, the lead auditor is required to determine the locations and business units of a company at which audit procedures should be performed.²³

The proposed amendments specify that the lead auditor would be required to determine the locations and business units at which audit procedures should be performed in all audits that involve "other auditors" and "referred-to auditors" (as proposed to be defined). When making this determination, the lead auditor would be required to 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.

These amendments, together with the amended supervisory requirements in AS 1201, are intended to make sure the lead auditor plays the central role in determining the overall audit scope in such audits. Based on information from the Board's oversight activities, the Board's proposal is consistent with the approach taken by a number of accounting firms.

²³

See AS 2101.14.



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Comparison with Standards of Other Standard Setters

Paragraph 24 of ISA 600 states that the group engagement team shall determine the type of work to be performed by the group engagement team, or the component auditors on its behalf, on the financial information of the components; and that the group engagement team shall also determine the nature, timing, and extent of its involvement in the work of the component auditors. For a component that is significant due to its individual financial significance to the group, paragraph 26 of ISA 600 states that the group engagement team, or a component auditor on its behalf, shall perform an audit of the financial information of the component using component materiality. For a component that is significant because it is likely to include significant risks of material misstatement of the group financial statements due to its specific nature or circumstances, paragraph 27 of ISA 600 states that the group engagement team, or a component auditor on its behalf, shall perform one or more of the following: (a) an audit of the financial information of the component using component materiality; (b) an audit of one or more account balances, classes of transactions or disclosures relating to the likely significant risks of material misstatement of the group financial statements; or (c) specified audit procedures relating to the likely significant risks of material misstatement of the group financial statements. For components that are not significant components, paragraph 28 of ISA 600 states that the group engagement team shall perform analytical procedures at the group level.²⁴

When the auditor of the group financial statements uses a component auditor's work, the requirements in AU-C Section 600 are similar to ISA 600.²⁵

ISA 600 does not contain requirements for situations in which the auditor divides responsibility for the audit with another accounting firm. AU-C Section 600 requires that the auditor design and implement appropriate responses to address the assessed risks of material misstatement of the financial statements.²⁶

²⁴ Paragraph 29 of ISA 600 describes the group engagement team's further course of action with respect to components that are not significant components if the group engagement team does not consider that sufficient appropriate audit evidence on which to base the group audit opinion will be obtained through the performance of certain procedures.

²⁵ See paragraphs .33 and .52–.58 of AU-C Section 600.

²⁶ See paragraph .33 of AU-C Section 600.



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C. Determining Compliance of Other Auditors with Independence and Ethics Requirements

See proposed paragraph .B4 of AS 2101

Currently, paragraph .06b of AS 2101 requires the auditor to determine compliance with independence and ethics requirements. In addition, for situations governed by AS 1205, paragraph .10 of AS 1205 requires the lead auditor ("principal auditor," as used in the terminology of AS 1205) to make inquiries concerning the other auditor's independence. Such inquiries may include, for example, obtaining a representation from the other auditor that the other auditor is independent.²⁷

Under PCAOB Rule 3520, *Auditor Independence*, all auditors involved in the audit (including the firms and personnel of the lead auditor and other auditors), must be independent of the audit client throughout the audit and professional engagement period. This requirement for the lead auditors and other auditors not only extends to the independence rules and standards of the PCAOB but also extends to the rules and regulations of the SEC under the federal securities laws.

The proposal would retain the overarching requirement in AS 2101.06b to determine the audit engagement's compliance with independence and ethics requirements. In lieu of the AS 1205 requirement, the proposal would require the lead auditor, in all audits in which the lead auditor supervises other auditors,²⁸ to determine each other auditor's compliance with the SEC and PCAOB independence and ethics requirements by:

- Gaining an understanding of each other auditor's knowledge of the SEC and PCAOB independence and ethics requirements and their experience in applying the requirements; and
- Obtaining a written representation from each other auditor that it is in compliance with SEC and PCAOB independence and ethics requirements.

²⁷ See AS 1205.10b.

²⁸ For the divided responsibility scenario, see discussion of proposed requirements of AS 1206 below in Section VII.B.3 of this appendix.



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Additionally, the lead auditor would be required to reassess the other auditor's compliance with ethics and independence requirements if circumstances change, for example, if the other auditor is engaged by the business unit under audit to perform additional non-audit services. This will necessitate ongoing communication between the lead auditor and other auditor during the audit so that the lead auditor can be informed about relevant changes in circumstances. Furthermore, the proposal provides that if, during the audit, the lead auditor becomes aware of information that contradicts a representation made by the other auditor regarding its compliance with the SEC and PCAOB independence and ethics requirements the lead auditor would be required to perform additional procedures to determine the effect of the information on the independence of the other auditor.

The proposal does not prescribe specific procedures for obtaining an understanding of the other auditors' knowledge of the SEC and PCAOB independence and ethics requirements, and their experience in applying the requirements. Sources of relevant information about other auditors may differ depending, for example, on whether the lead auditor and other auditors are affiliated with the same network of audit firms. The following are examples of types of information from the other auditor that may be relevant to the lead auditor's understanding of the other auditors' knowledge of the SEC and PCAOB independence and ethics requirements, and their experience in applying the requirements:

- The type, frequency, and substance of independence and ethics training that the other auditor provides to its personnel who participate in the audit;
- The other auditor's policies and procedures for ensuring that the firm and its personnel comply with the independence and ethics requirements, including compliance with PCAOB Rule 3520, *Auditor Independence*;²⁹
- The other auditor's process for determining that the other auditor, including the firm and its applicable personnel, do not have financial or employment relationships that might impair the lead auditor's independence on the audit;³⁰

²⁹ See also QC Sec. 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*.

³⁰ See Regulation S-X Rules 2-01(c)(1) and 2-01(c)(2).



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- The other auditor's process for obtaining timely information about the audit client and its affiliates from which the other auditor firm is required to maintain independence, including an understanding of all non-audit services initiated or about to be initiated for the audit client;³¹ and
- Any business relationships between the other auditor (including the firm and its applicable personnel) and the audit client, or persons associated with the audit client in a decision-making capacity, such as officers, directors, or substantial stockholders.³²

Comparison with Standards of Other Standard Setters

Paragraph 19(a) of ISA 600 states that the group engagement team shall obtain an understanding of, among other things, whether the component auditor understands and will comply with the ethical requirements that are relevant to the group audit and, in particular, is independent.

According to paragraph 40(b) of ISA 600, the group engagement team shall communicate the requirements relevant to the group audit to a component auditor on a timely basis, and this communication shall include, among other things, the ethical requirements that are relevant to the group audit and in particular, the independence requirements.

AU-C Section 600 contains requirements that are similar to those in ISA 600.

³¹ PCAOB and SEC independence rules define "affiliate of the audit client" at PCAOB Rule 3501(a)(ii) and Regulation S-X Rule 2-01(f)(4). For rules regarding the prohibition of non-audit services, see Regulation S-X Rules 2-01(c)(4) and 2-01(b), PCAOB Rule 3522, *Tax Transactions*, and PCAOB Rule 3523, *Tax Services for Persons in Financial Reporting Oversight Roles*. See also PCAOB Rule 3521, *Contingent Fees*.

³² See Regulation S-X Rule 2-01(c)(3).



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D. Registration Status of Other Auditors that Play a Substantial Role on an Audit

See proposed paragraph .B5 of AS 2101

Existing PCAOB Rule 2100 requires a public accounting firm to be registered if the firm: (a) prepares or issues any audit report with respect to any issuer, broker, or dealer or (b) plays a substantial role in the preparation or furnishing of an audit report with respect to any issuer, broker, or dealer. However, there have been situations in which a firm playing a substantial role on an audit was not registered pursuant to the rules of the PCAOB.

The proposal provides that the lead auditor may use the work of an other auditor that would play a substantial role only if the other auditor is registered pursuant to the rules of the PCAOB. The proposal does not change Rule 2100 or the related definition, but is intended to promote compliance with the existing rule.

Comparison with Standards of Other Standard Setters

The IAASB and ASB do not have analogous requirements.

E. Understanding the Qualifications of Other Auditors and Determining the Lead Auditor's Ability to Communicate with Other Auditors and Gain Access to Their Work Papers

See proposed paragraph .B6 of AS 2101

PCAOB standards have long recognized the importance of technical training and proficiency of the personnel performing the audit, and this is particularly important for senior engagement personnel.³³

In situations in which the lead auditor supervises the other auditors in accordance with AS 1201, existing PCAOB standards require that the knowledge, skill, and ability of engagement team members with significant engagement responsibilities should be commensurate with the assessed risks of material misstatement.³⁴

³³ See, e.g., AS 1010 and QC 20.11-.12.

³⁴ See AS 2301.5.a.



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In situations in which the lead auditor uses the other auditor's work in accordance with AS 1205, existing PCAOB standards require the lead auditor ("principal auditor" in the terminology of AS 1205) to make inquiries concerning the professional reputation of the other auditor.³⁵ This may include, among other things, ascertaining the other auditor's familiarity with accounting principles generally accepted in the United States of America and with the standards of the PCAOB.³⁶

The Board's proposal builds on and strengthens the existing requirements by requiring that when planning the audit the lead auditor: (i) gain an understanding of the qualifications of the other auditors who assist the lead auditor with planning or supervision and (ii) determine that the lead auditor is able to communicate with the other auditors and gain access to the work of other auditors. The proposed requirements seek to apply a balanced and practical approach by focusing the lead auditor's attention on the qualifications of the more senior engagement team members of the other auditor, that is, those who assist the lead auditor with planning or supervision. The proposal would allow the lead auditor to seek assistance from these senior engagement team members, when appropriate, for certain procedures with respect to supervising the work of other engagement team members at the other auditor.³⁷

1. *Understanding the Qualifications of Other Auditors*

Gaining an understanding of the knowledge, skill, and ability of the other auditor's supervisory personnel is necessary for determining the extent of the lead auditor's supervision of the other auditors. Lack of appropriate qualifications by other auditors who assist the lead auditor with planning or supervision could have an adverse effect on the effectiveness of supervision and may increase the likelihood that auditors would not identify material misstatements in the company's financial statements.

Gaining an understanding of the qualifications under the proposal would necessarily involve gaining an understanding of the knowledge, skill, and ability of the relevant personnel, for example, experience in the industry or in the jurisdiction³⁸ in

³⁵ See AS 1205.10.

³⁶ See AS 1205.10c(ii).

³⁷ See, e.g., AS 1015.06 and AS 1201.06.

³⁸ The proposal would add an explanatory phrase "including relevant knowledge of foreign jurisdictions" to AS 2101.16.



which the company operates, knowledge of the relevant financial reporting framework, and knowledge of PCAOB standards and rules, and of SEC rules and regulations. Possible sources of information that are relevant to the lead auditor's understanding of the other auditors' qualifications include the lead auditor's own experience working with the relevant personnel, information about training or internal inspection results regarding those personnel, and publicly disclosed disciplinary action by regulators against relevant personnel.

2. *Determining the Lead Auditor's Ability to Communicate with Other Auditors and Gain Access to Their Work Papers*

The proposed requirement to determine the auditor's ability to communicate with the other auditors and gain access to their working papers is designed to alert the lead auditor to difficulties it may encounter in obtaining and evaluating audit evidence collected by other auditors so that the lead auditor may take appropriate action. For example, privacy laws of certain jurisdictions may create obstacles for the transfer of the other auditor's documentation from the country in which the other auditor is located to the lead auditor's country. In these instances, engagement team members from the lead auditor may need to travel to the country where the working papers are located to access the working papers and perform their review. However, if effective methods of remote access to the working papers are available to the lead auditor, the proposal would not preclude the use of such methods. The proposal would not change the existing requirement in AS 1215.19 for obtaining, reviewing, and retaining certain documentation related to the other auditor's work by the office of the firm issuing the auditor's report.

If the lead auditor cannot obtain sufficient appropriate audit evidence, a limitation on the scope of the audit may exist. This may require the engagement partner to qualify the audit opinion or disclaim an opinion.³⁹

Comparison with Standards of Other Standard Setters

Paragraph 19 of ISA 600 includes provisions regarding the group engagement team's understanding of the component auditor and requires that, if the group engagement team plans to request a component auditor to perform work on the

³⁹ See AS 2810.35. See also paragraphs .22 through .34 of AS 3101 (currently AU sec. 508), *Reports on Audited Financial Statements*, which contains requirements regarding audit scope limitations.



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financial information of a component, the group engagement team obtain an understanding of, among other things:

- The component auditor's professional competence; and
- The group engagement team's ability to be involved in the work of the component auditor to the extent necessary to obtain sufficient appropriate audit evidence.

AU-C Section 600 contains requirements that are similar to those in ISA 600.

Questions:

21. The proposed requirements for determining whether a firm's participation is sufficient for it to serve as the lead auditor depend on the risks of material misstatement associated with the portion of the financial statements audited by the firm. (These requirements would apply regardless of whether the other auditor is from the same audit network as the lead auditor.) Should the Board consider alternative or additional criteria for determining whether a firm's participation is sufficient? For example, should the Board impose a quantitative threshold or specify criteria covering the locations of the company's principal assets, principal operations, or corporate offices? How would such criteria help address specific issues in practice?
22. What are the practical challenges with applying the proposed engagement partner's determination of the firm's sufficiency of participation in the audit? What changes, if any, should be made to address those challenges?
23. Are there situations in practice in which the proposed sufficiency determination would cause changes in the firm serving as lead auditor? If so, what are these situations? What are the potential effects of those changes, including potential effects on costs and audit quality? What changes to the proposal, if any, would mitigate these issues?
24. The proposed sufficiency determination would apply for audits in which the lead auditor supervises the work of other auditors and audits in which the lead auditor divides responsibility for the audit with another firm. Should



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there be different requirements for the divided-responsibility scenario, for example, should there be additional criteria that require increased lead auditor participation in a divided responsibility scenario? If so, what should those requirements be?

25. Are the proposed requirements for the lead auditor to hold discussions with and obtain information from other auditors and referred-to auditors to identify and assess the risks of material misstatement appropriate and clear? Are there any practical challenges with this requirement? If so, what are they, and how could the proposed requirements be revised to address the challenges?
26. Are the additional proposed requirements for the lead auditor when planning an audit that involves other auditors, which address independence and ethics; registration; and qualifications of and communications with other auditors, appropriate and clear? Are there requirements that should be added to or removed from Appendix B of AS 2101? If so, what are those requirements and why should they be included or excluded?
27. The proposed amendments require the lead auditor to gain an understanding of each other auditor's knowledge of the SEC and PCAOB independence and ethics requirements and their experience in applying the requirements. Are there any additional costs or practical challenges associated with this? If so, what are they, and how could the proposed requirements be revised to mitigate these issues?
28. Should the requirement for the lead auditor to gain an understanding of the knowledge, skill, and ability of the other auditors be limited to engagement team members who assist the lead auditor with planning and supervision?
29. Are the proposed requirements to determine that the lead auditor is able to communicate with the other auditors and gain access to their work papers appropriate and clear? If not, what changes to the proposed requirements are necessary?



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30. Are the proposed amendments to the requirements for determining the locations and business units at which audit procedures should be performed clear and appropriate?

IV. Proposed Amendments to AS 1201

A. Overview of the Proposed Supervisory Approach

The Board's proposal is intended to improve the quality of audits that involve other auditors for whom the lead auditor assumes responsibility by requiring, among other things, that the lead auditor supervise the other auditors under AS 1201, as proposed to be amended.

Currently, the risk-based supervision approach described in AS 1201 does not apply to situations in which the lead auditor uses the work and reports of other auditors under AS 1205. The proposal would supersede AS 1205 and extend the application of AS 1201 to all audits involving other auditors for which the lead auditor assumes responsibility, which in turn should improve the lead auditor's supervision of other auditors. Under the proposal, the extent of the lead auditor's supervision of the work of other auditors is based on, among other things, the risks of material misstatement to the company's financial statements and the knowledge, skill, and ability of the other auditor.⁴⁰

Additionally, the proposal would provide more specific direction for the supervision of other auditors.

Currently, AS 1201 sets forth the general framework for supervision of engagement team members, including the nature and extent of supervisory activities. It also states that the engagement partner is responsible for supervision but may seek assistance from appropriate engagement team members. It does not, however, delineate the responsibilities of the lead auditor from those of other auditor supervisory personnel.

When other auditors participate in the audit, the lead auditor, as the firm that issues the audit report, is responsible for making sure that sufficient appropriate audit evidence has been obtained, and appropriately evaluated, to support the opinion in the audit report. Because of the lead auditor's central role in the audit, the Board's proposal

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See AS 1201.06 and proposed AS 1201.B1.



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would require that certain supervisory procedures be performed by the lead auditor. These proposed procedures would constitute an integral part of the supervisory activities described by AS 1201; they are designed to improve the effectiveness of the lead auditor's supervision of the work of other auditors under AS 1201. The proposed procedures are described in more detail later in this appendix.

Effective supervision typically necessitates two-way interaction with the supervised party. Thus, the Board's proposal would require the lead auditor to hold discussions with and obtain information from the other auditors as necessary for the performance of the proposed procedures. The proposed amendments are intended to foster effective interaction between the lead auditor and other auditors.

The proposed approach to the lead auditor's supervision of other auditors would be consistent with, and take into account recent developments at some accounting firms, which have been observed through the Board's oversight activities.

B. Proposed Supervision Procedures to Be Performed by the Lead Auditor

To facilitate the supervision of the other auditors, the proposed amendments would establish specific requirements for the lead auditor in the following areas:

- Informing other auditors of their responsibilities;
- Reviewing a description of the audit procedures to be performed by the other auditors;
- Directing the other auditors to provide specific documentation;
- Obtaining from the other auditors a written report describing the other auditor's procedures, findings, conclusions, and if applicable, opinion; and
- Reviewing the results of the work of the other auditors.

The proposed amendments are designed to improve the effectiveness of the lead auditor's supervision of the work of other auditors, which in turn should increase the likelihood that the auditors identify material misstatements in the financial statements. The proposed amendments would supplement existing requirements in AS 1201.05, providing more specific direction for applying the general supervisory procedures to the



supervision of other auditors. The following discusses the proposed supervision requirements in more detail.

1. Informing Other Auditors of Their Responsibilities

See proposed paragraph .B2a of AS 1201

Currently, AS 1201 requires informing engagement team members of their responsibilities, including the objectives of their assigned procedures, details about the procedures to be performed, and other matters that could affect their assignment. AS 1205 does not include a specific requirement⁴¹ for the lead auditor ("principal auditor," as used in the terminology of AS 1205) to inform other auditors of their responsibilities.

The lead auditor, as the auditor issuing the audit report, necessarily has the ultimate responsibility for the overall scope of the audit, including the determination of materiality, risk assessments, and overall audit plan for responding to the assessed risks. This includes determining the locations or business units at which audit procedures are performed. To promote proper supervision of other auditors, the Board's proposal would require the lead auditor to inform the other auditors of the following in writing:

- The scope of work to be performed (e.g., location or business unit at which work is to be performed⁴² and the general type of work to be performed, which could range from a few specified audit procedures to a standalone audit); and
- Tolerable misstatement for the location or business unit, identified risks of material misstatement associated with the location or business unit, and, if

⁴¹ According to AS 1205.12, the principal auditor should consider, among other things, reviewing the audit programs of the other auditor and issuing instructions to the other auditor.

⁴² As discussed previously, in multi-location engagements that involve other auditors, the lead auditor would be required to determine locations or business units at which audit procedures should be performed.



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determined, the amount below which misstatements are clearly trivial and do not need to be accumulated.⁴³

Comparison with Standards of Other Standard Setters

Paragraph 40 of ISA 600 includes provisions regarding the group engagement team's communication of requirements to the component auditor. This communication sets out the work to be performed and includes communication requirements in the areas of materiality and significant risks of material misstatement.

AU-C Section 600 contains requirements that are similar to those in ISA 600.

2. *Reviewing a Description of the Audit Procedures to Be Performed by the Other Auditor*

See proposed paragraph .B2b of AS 1201

Existing PCAOB standards require the auditor to develop and document an audit plan that includes a description of, among other things: (i) the planned nature, timing, and extent of the risk assessment procedures and (ii) the planned nature, timing, and extent of tests of controls and substantive procedures.⁴⁴ In addition, in situations governed by 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.⁴⁵ In situations governed by AS 1205, the lead auditor ("principal auditor," as used in the terminology of AS 1205) should consider reviewing the audit programs of the other auditor.⁴⁶

⁴³ Paragraphs .10-.11 of AS 2810, *Evaluating Audit Results*, require auditors to accumulate misstatements identified during the audit, other than those that are clearly trivial, and provides that auditors may designate an amount pursuant to the standard below which misstatements are trivial and do not need to be accumulated. The proposed requirement indicates that the lead auditor makes the determination of the clearly trivial threshold under AS 2810, if such a threshold is determined.

⁴⁴ AS 2101.10.

⁴⁵ AS 1201.05a.(2).

⁴⁶ AS 1205.12.



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To promote proper supervision of other auditors and proper coordination of the overall work to be performed on the audit, the Board's proposal would require the lead auditor to obtain and review the other auditor's description of the nature, timing, and extent of audit procedures to be performed pursuant to the scope of the work communicated in accordance with proposed AS 1201.B2a(1). Based on its review, the lead auditor would be required to determine whether any changes to the other auditor's planned procedures were necessary and, if so, discuss such changes with the other auditor and communicate them in writing to the other auditor.

The proposed requirement provides the flexibility for other auditors – who may be more familiar with the circumstances at the location or business unit where they would work – to design the detailed procedures for the scope of work they are instructed to perform and the associated risks of material misstatement, subject to the lead auditor's review and approval. On the other hand, the other auditors might not always be best suited to design the detailed procedures to be performed. This may be the case if the other auditors are unfamiliar with the location or business unit or lack experience addressing certain unique risks present at the location or business unit. Thus, the proposal provides that, in some situations, it may be necessary for the lead auditor – rather than the other auditor – to determine the nature, timing, and extent of the other auditor's work.

Comparison with Standards of Other Standard Setters

Paragraph 24 of ISA 600 states that the group engagement team shall determine the type of work to be performed by the group engagement team, or the component auditors on its behalf, on the financial information of the components.

Paragraph 30 of ISA 600 requires, among other things, that the group engagement team be involved in a component auditor's risk assessment if the component auditor performs an audit of the financial information of a significant component. The nature, timing, and extent of this involvement shall include:

- Discussing with the component auditor the susceptibility of the component to material misstatement of the financial information due to fraud or error; and
- Reviewing the component auditor's documentation of identified significant risks of material misstatement of the group financial statements. Such documentation may take the form of a memorandum that reflects the



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component auditor's conclusion with regard to the identified significant risks.

Further, paragraph 31 states, if significant risks of material misstatement of the group financial statements have been identified in a component on which a component auditor performs the work, the group engagement team shall evaluate the appropriateness of the further audit procedures to be performed to respond to the identified significant risks of material misstatement of the group financial statements. Based on its understanding of the component auditor, the group engagement team shall determine whether it is necessary to be involved in the further audit procedures.

AU-C Section 600 contains requirements that are similar to those in ISA 600.

3. Directing the Other Auditors to Provide Specific Documentation

See proposed paragraph .B2c of AS 1201

Supervision under PCAOB standards necessarily involves review of the work performed. Under the proposal, the lead auditor would be required to determine the necessary extent of its review of documentation of the other auditor's work and communicate to the other auditor in writing the documents that the other auditor should provide for the lead auditor's review (as discussed in more detail below in this appendix). Currently, AS 1215.19 describes documentation of the other auditor's work that the office issuing the auditor's report must obtain, review, and retain. Depending on the extent of supervision determined by the lead auditor pursuant to AS 1201.06, the lead auditor would determine the extent of the additional review of other auditors' work papers necessary to satisfy the requirements of AS 1201. For example, the lead auditor could determine it necessary to request additional documentation for review with respect to the work performed by less experienced other auditors, or with respect to an area of heightened risk of material misstatement. Pursuant to proposed paragraph AS 1201.B2c, the lead auditor would communicate to other auditors the documentation the lead auditor intends to review. For example, the lead auditor can specify individual documents, types of documents, or audit areas that it intends to review.

Comparison with Standards of Other Standard Setters

As previously mentioned, paragraph 40 of ISA 600 includes provisions regarding the group engagement team's communication of requirements to the component



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auditor. This communication includes the form and content of the component auditor's communication with the group engagement team.

Paragraph 42 indicates that the group engagement team is required to evaluate the component auditor's communication and to (a) discuss significant matters arising from that evaluation with the component auditor, component management or group management, as appropriate; and (b) determine whether it is necessary to review other relevant parts of the component auditor's audit documentation.

AU-C Section 600 contains requirements that are similar to those in ISA 600.

4. *Obtaining the Other Auditor's Written Report*

See proposed paragraph .B2d of AS 1201

AS 1205 is premised on the lead auditor's use of the work and report of the other auditor, implicitly requiring the lead auditor to obtain that report regardless of whether the auditor makes reference or divides responsibility. The proposed amendments would make the requirement more explicit and extend to all situations in which other auditors are supervised under AS 1201. Specifically, the proposal would require the lead auditor to obtain from the other auditor a written report describing the other auditor's procedures, findings, conclusions, and if applicable, opinion.

This proposed requirement is intended to make sure that the lead auditor is appropriately informed about the work performed by the other auditor and the results of that work. It also should reinforce to other auditors their responsibility to plan and perform their work with due care, complying with PCAOB standards. The notion of other auditor accountability is not new. AS 1205.03 (which would be superseded by the proposal) states that "regardless of the principal auditor's decision [to assume the responsibility for the other auditor's work or divide the responsibility for the audit with the other auditor] the other auditor remains responsible for the performance of his own work and for his own report." While other auditors have obligations with respect to their work, those obligations do not diminish the engagement partner's overall responsibility for the engagement and its performance.⁴⁷

The proposed requirement to obtain a report from the other auditor is generally consistent with existing auditing practice. Observations from the Board's oversight

⁴⁷ See, e.g., AS 1201.03 and AS 2101.03.



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activities indicate that many accounting firms have developed firm-specific guidance for written communication to the lead auditor of the results of work performed on the audit by other firms. Such communication can vary from a targeted reporting on specified audit procedures (e.g., inventory observation) to an audit report on the financial statements of a company's subsidiary.

Comparison with Standards of Other Standard Setters

Paragraph 41 of ISA 600 states that the group engagement team shall request the component auditor to communicate matters relevant to the group engagement team's conclusion with regard to the group audit and that such communication shall include, among other things, the component auditor's overall findings, conclusions or opinion.

AU-C Section 600 contains requirements that are similar to those in ISA 600.

5. *Reviewing the Results of the Other Auditor's Work*

See proposed paragraph .B2e of AS 1201

Under AS 1201.05c, the auditor should review the work of engagement team members to evaluate whether: (i) the work was performed and documented; (ii) the objectives of the procedures were achieved; and (iii) the results of the work support the conclusions reached.⁴⁸ In situations governed by AS 1205.12, the lead auditor ("principal auditor," as used in the terminology of AS 1205) must obtain, review, and retain certain documentation prepared by the other auditors, and should consider performing a number of additional review procedures.

In conjunction with the lead auditor's review of the work performed by other auditors pursuant to AS 1201.05c, the proposal would require the lead auditor to determine: (i) whether the other auditor complied with the written communications received and (ii) whether additional audit evidence should be obtained with respect to the work performed by the other auditor.

⁴⁸ Additionally, AS 1201.05b requires the engagement partner or other supervisors to direct engagement team members to bring significant accounting and auditing issues to their attention so they can evaluate those issues and determine that appropriate actions are taken in accordance with PCAOB standards. That requirement also would apply in the supervision of other auditors.



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The proposed requirements are designed to be scalable for all situations that involve other auditors. For example, the Board's proposal would not require that the lead auditor review all of the other auditor's work papers to determine whether the other auditor performed its work as requested by the lead auditor. Instead, the lead auditor's determination should be based on: (i) the review of documentation that the lead auditor requested from the other auditor; (ii) the review of the other auditor's written report describing the other auditor's procedures, findings, conclusions, and if applicable, opinion; and (iii) discussions with the other auditor and other information obtained during the audit. Consistent with existing standards, the extent of the lead auditor's review should be determined based on requirements of AS 1201. For example, the higher the likelihood of the risk of material misstatement associated with the areas in which other auditors perform audit procedures, the greater should be the extent of the lead auditor's supervision of the other auditors' work.

The proposed requirement to determine whether additional evidence is needed is intended to address situations in which, for example, the lead auditor determines that the other auditor did not perform the procedures as instructed or sufficient appropriate audit evidence was not obtained with respect to the amounts and disclosures audited by the other auditor. If the other auditor did not perform auditing procedures in accordance with PCAOB standards, the lead auditor would need to determine whether additional procedures should be performed to achieve its objectives in the audit. In another example, the lead auditor's review of the other auditor's work could identify a previously unidentified risk of material misstatement. Under the Board's proposal, the lead auditor would be required to determine the appropriate audit response to the risk.⁴⁹

Comparison with Standards of Other Standard Setters

Paragraph 44 of ISA 600 states that the group engagement team shall evaluate whether sufficient appropriate audit evidence has been obtained from the audit procedures performed on the consolidation process and the work performed by the group engagement team and the component auditors on the financial information of the components, on which the group audit opinion will be based. Paragraph 42 of ISA 600 also states that the group engagement team shall evaluate the component auditor's communication and determine whether it is necessary to review other relevant parts of the component auditor's audit documentation.

⁴⁹

See AS 2810.35 and .36, and proposed AS 1201.B2d.



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Paragraph 43 of ISA 600 states that, if the group engagement team concludes that the work of the component auditor is insufficient, the group engagement team shall determine what additional procedures are to be performed and whether they are to be performed by the component auditor or by the group engagement team.

AU-C Section 600 contains requirements that are similar to those in ISA 600.

C. Supervision of the Other Auditor's Work in a Multi-tiered Audit that Involves Other Auditors

See proposed paragraph .B3 of AS 1201

In some audits that involve other auditors, the engagement team may be organized in a multi-tiered structure ("multi-tiered audit") in which an other auditor audits 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 or assists the lead auditor in supervising the second other auditor. For example, in an audit of a U.S. multinational corporation that consolidates the results of its European operations in the U.K., the engagement team might consist of a U.S. firm as lead auditor, a U.K. auditor for the European operations, and a second other auditor who audits a business unit in Germany that is consolidated into the European operations audited by the U.K. firm. As another example, the lead auditor might ask an other auditor to assist in the supervision of a second other auditor.

The Board's proposed requirements for the supervision of other auditors are designed to be scalable for multi-tiered audits. Specifically, the proposal allows 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. The determination of whether it is appropriate for the first other auditor to act in this capacity would be based on the existing factors for determining the extent of supervision in AS 1201.06. For example, the lead auditor may determine that it would supervise the second other auditor directly if the first other auditor's knowledge of a particular industry is insufficient to effectively review the second other auditor's work. Additionally, it may be more appropriate for the lead auditor to supervise the second other auditor directly because of the nature and significance of the risks associated with the location or business unit at which the second other auditor performs audit procedures, for example, if the company's highest risk transactions were initiated and recorded at that business unit.



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Under the proposal, in a multi-tiered audit, the lead auditor would be responsible for the supervision of the entire audit, including the supervision of all other auditors. The lead auditor also would be responsible under the proposal for directly communicating to all the other auditors the scope of the work to be performed, tolerable misstatement, identified risks of material misstatement, and , if determined, the amount below which misstatements are clearly trivial and do not need to be accumulated. If a first other auditor performs supervisory activities with respect to a second other auditor, the lead auditor would be required to evaluate the first other auditor's supervision of the second other auditor's work.

When evaluating the first other auditor's supervision of the second other auditor's work, the lead auditor would not be expected to reperform the first other auditor's supervisory activities. Instead the lead auditor would be expected to take steps to determine that the first other auditor properly performed the assigned supervisory activities, there was proper coordination of the work of the first and second other auditors, as applicable, and significant matters arising during the audit were properly addressed. Such steps may include holding discussions with the first other auditor, and reviewing the other auditors' audit plans, written reports, or other documentation. The extent of the lead auditor's evaluation would depend on the nature of the work performed by the second other auditor, the results of the work, and the necessary extent of the lead auditor's supervision of the first other auditor's work.

The proposal would not change the requirements of AS 1215.19 for the office of the firm issuing the auditor's report to obtain, review, and retain certain documentation supporting the work performed by other auditors. In a multi-tiered audit, the office issuing the auditor's report would be required to obtain, review, and retain the specified documentation prepared by the first other auditor and second other auditor.

The proposed requirements for the supervision of the other auditor's work in a multi-tiered audit that involve other auditors would also apply to audits in which there are multiple second other auditors.

Comparison with Standards of Other Standard Setters

The IAASB and ASB do not have analogous requirements.



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Questions:

31. Are the proposed procedures to be performed by the lead auditor with respect to the supervision of the other auditor's work appropriate and clear? If not, how should the proposed requirements be revised?
32. Currently, AS 1205.12 describes certain procedures that the lead auditor should consider performing when using the work of the other auditor (e.g., visiting the other auditor), which are not included in the proposal. Should the lead auditor be required to perform these or any other procedures? If so, what additional procedures should be required?
33. Are the requirements for the written report from the other auditor sufficiently clear? Are these requirements appropriately scalable to the nature and significance of the work referred to the other auditor? Would the proposed requirement for the lead auditor to obtain a written report from the other auditor result in a significant change in practice? If so, what is the estimated economic impact (e.g., costs and benefits) of this change?
34. Is the scalability of the proposed supervision amendments clear and appropriate? If not, what changes are necessary? Are the proposed requirements for situations in which the lead auditor directs an other auditor to perform supervisory procedures with respect to a second other auditor on behalf of the lead auditor clear? If not, how should the proposed requirements be revised?
35. In a multi-tiered audit where the lead auditor directs the first other auditor to perform certain procedures with respect to the second other auditor, is the proposed requirement that lead auditor inform directly all other auditors of certain other specific matters appropriate? If not, how should the proposed requirements be revised?
36. In a multi-tiered audit, is the proposed requirement for the lead auditor to evaluate the first other auditor's supervision of the second other auditor's work clear? If not, how should the proposed requirements be revised?



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37. Do the proposed requirements sufficiently cover the types of multi-tiered structures used today? If not, what other multi-tiered structures are used and what changes are needed to appropriately cover those situations?
38. Do issues exist when the lead auditor directs an other auditor to perform supervisory procedures with respect to a second other auditor on behalf of the lead auditor that should be addressed in AS 2101, for example, with respect to the qualifications of other auditors? What are the issues and what proposed requirements should be added to appendix B of AS 2101?
39. Should certain of the proposed supervision procedures be required to be performed by individuals at the office issuing the auditor's report versus the firm issuing the auditor's report? If so, which procedures? Why should such required procedures be confined to individuals located at a particular office of the firm issuing the auditor's report?
40. Do the proposed requirements provide sufficient emphasis on the need for two-way communication between the lead auditor and the other auditor throughout the audit? If not, what changes to the requirements are necessary to further promote such communication?

V. Proposed Amendments to AS 1215

A. Proposed Amendments to AS 1215 Related to Documentation of the Review of Documents Not Retained by the Office Issuing the Auditor's Report

Existing PCAOB standards require the engagement partner and other engagement team members assisting with supervisory responsibilities to review the work of engagement team members to evaluate whether: (i) the work was performed and documented; (ii) the objectives of the procedures were achieved; and (iii) the results of the work support the conclusions reached.⁵⁰ In multi-location engagements, this review may include audit documentation that is retained outside the office issuing the auditor's report or even outside the lead auditor's firm.

The proposed amendments include a requirement in proposed paragraph .19A of AS 1215 that is designed to provide additional information about reviews performed by

⁵⁰ AS 1201.05c.



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the lead auditor of the working papers of other auditors that were not retained. According to this proposed requirement, such information must include a description of the work papers reviewed, the reviewer, and the date of such review (consistent with the existing requirement in AS 1215.06b).

For example, other auditors could perform audit procedures with respect to a company's foreign subsidiary. A senior team member of the lead auditor (for example, a partner or senior manager) could travel to and review the other auditor's working papers in the other auditor's office that is located in the same country as the company's subsidiary.⁵¹ If there are restrictions on the transfer of the other auditor's documentation from the country of the company's subsidiary to the country of the lead auditor, a list of documents (including a description of documents) supporting the work performed by the other auditor with respect to the company's foreign subsidiary that were reviewed by the senior manager would allow the engagement partner in the office issuing the auditor's report (or other internal and external reviewers) to determine, for example, the extent of the senior manager's review of the documents located in the other auditor's office. This does not substantively affect the requirements in AS 1215.18-.19, which are discussed below.

The Board considered an alternative requirement for the lead auditor to make a list of all documents in the other auditor's files, including those not reviewed by the lead auditor. Requiring the lead auditor to compile a list of all the audit documentation of all the other auditors participating in the audit could be burdensome, especially on larger audit engagements. The Board is seeking comment on whether this alternative requirement is preferable to the requirement in the proposed amendments.

B. Proposed Amendments to AS 1215 Related to Terminology

See proposed amendments for AS 1215

Because the proposed amendments would define the term "other auditors" in AS 1201 and supersede AS 1205, the proposed amendments would make conforming changes to AS 1215.18 and .19.

Currently, AS 1215.18 requires, among other things, that audit documentation supporting the "work performed by other auditors (including auditors associated with

⁵¹ In all cases, audit documentation supporting the work of the other firm must be accessible to the office issuing the auditor's report. See AS 1215.18.



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other offices of the firm, affiliated firms, or non-affiliated firms) must be retained by or be accessible to the office issuing the auditor's report." AS 1215.19 currently requires that the office issuing the auditor's report obtain, and review and retain, prior to the report release date, certain documentation related to the "work performed by other auditors (including auditors associated with other offices of the firm, affiliated firms, or non-affiliated firms)."⁵² The proposed amendments to each paragraph revise the paragraphs to delete the parenthetical phrases and revise the language to talk about documentation of the "work performed by other offices of the firm and other auditors," citing the proposed definition of "other auditor" in the amendments to AS 1201.

Further, the proposed amendments would delete a clarifying sentence at the end of AS 1215.19 which currently states, "[i]f 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*." This clarification is no longer needed because AS 1205 would be superseded and the proposed standard on divided responsibility uses the term "referred-to auditor" instead of "other auditor."

C. Comparison with Standards of Other Standard Setters

The IAASB and ASB do not have requirements analogous to the proposed requirements described in Section A above. As it pertains to Section B, paragraph 41 of ISA 600 states that the group engagement team shall request the component auditor to communicate matters relevant to the group engagement team's conclusion with regard to the group audit. The standard requires the communication to include, among others: (a) whether the component auditor has complied with the group engagement team's requirements; (b) information on instances of non-compliance with laws or regulations that could give rise to a material misstatement of the group financial statements; (c) a list of uncorrected misstatements of the financial information of the component; (d) description of significant deficiencies in internal control at the component level; (e) any other matters that may be relevant to the group audit or that the component auditor wishes to draw to the attention of the group engagement team; and (f) the component auditor's overall findings, conclusions or opinion.

⁵² For audits that involve other auditors, proposed Appendix B of AS 1201 sets forth the requirements for the lead auditor's review of the documentation of other auditors' work. This includes but is not limited to the documents listed in AS 1215.19.



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Questions:

41. The proposed requirement in AS 1215.19A is designed to provide additional information about the review of working papers performed by the lead auditor. Is the proposed requirement appropriate and clear? Why or why not? What other information about the review of the working papers performed by the lead auditor would be appropriate?
42. The proposal does not require that the lead auditor make a list of all documents in the other auditor's files, including those not reviewed by the lead auditor. Should the lead auditor be required to document work papers in the other auditor's files that the lead auditor has not reviewed? Would such a requirement improve audit quality? What potential costs or unintended consequences, if any, would be associated with such a requirement? What practical difficulties would there be in complying with such a requirement?
43. In addition to the information currently in AS 1215.19, should the office issuing the auditor's report be required to obtain, review, and retain other important information supporting the other auditor's work, e.g., (1) information about related parties or relationships or transactions with related parties previously undisclosed to the auditor or determined to be a significant risk; or (2) information about 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?
44. In addition to the information currently in AS 1215.19g about all significant deficiencies and material weaknesses in internal control over financial reporting, should the office issuing the auditor's report be required to obtain, review, and retain information about all control deficiencies identified by other offices of the firm and other auditors?

VI. Proposed Amendment to AS 1220

See proposed amendment to paragraph .10a of AS 1220

Under existing PCAOB standards, the engagement quality reviewer should evaluate the significant judgments made by the engagement team and the related conclusions reached in forming the overall conclusion on the engagement and in



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preparing the engagement report.⁵³ The Board's proposal includes an amendment to AS 1220, which would specifically require the engagement quality reviewer, in an audit involving "other auditors" or "referred-to auditors" (as proposed to be defined), to evaluate 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. (The corresponding proposed requirement for the engagement partner is described in proposed AS 2101.B2.)

Comparison with Standards of Other Standard Setters

The IAASB and ASB do not have analogous requirements.

Questions:

45. Should there be a requirement (as proposed) for the engagement quality reviewer to focus the reviewer's attention on the engagement partner's determination of the firm's sufficiency of participation in the audit?
46. Are there any additional engagement quality review procedures that should be required for audits that involve "other auditors" or "referred-to auditors" (as proposed to be defined)?

VII. Proposed New Standard for Audits that Involve Referred-to Auditors

Currently, situations in which the auditor divides responsibility for the audit with another accounting firm are governed by AS 1205.⁵⁴ The Board's proposal would supersede AS 1205 and retain, with certain modifications, the relevant requirements for the divided-responsibility scenario in a proposed new standard, AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*.

The proposed new standard, similar to AS 1205, would apply in situations in which the lead auditor divides responsibility for an audit with another public accounting firm ("referred-to auditor," as discussed in Section II.C). Consistent with AS 1205, the proposed new standard would not require the lead auditor to supervise the work of the

⁵³ AS 1220.09.

⁵⁴ As discussed above, AS 1205 also includes requirements for audits in which the auditor assumes responsibility for the work of another firm.



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referred-to auditor; rather, each auditor is required to supervise its respective engagement team members in accordance with AS 1201. The proposed new standard would not change the auditor's responsibilities with respect to other standards of the PCAOB. For example, both the lead auditor and referred-to auditor would be required to comply with PCAOB standards when scoping their respective audits and making materiality determinations.⁵⁵

In general, the proposed new standard would establish certain requirements for the lead auditor that would be based on provisions in AS 1205. These proposed requirements would require the lead auditor to:

- Perform procedures with respect to the audit of the referred-to auditor;
- Obtain a representation from the referred-to auditor regarding the referred-to auditor's compliance with independence and ethics requirements of the PCAOB and the SEC;
- Determine, based on inquiries made to the referred-to auditor and other information obtained by the lead auditor during the audit, that the referred-to auditor knows the relevant requirements of the applicable financial reporting framework, standards of the PCAOB, and financial reporting requirements of the SEC; and
- Disclose in the lead auditor's report: (i) the division of responsibility between the lead auditor and referred-to auditor, and (ii) the magnitude of the portions of the company's financial statements audited by the auditors.

The proposed new standard would provide the following new terms and requirements:

- New terms "lead auditor" (same as the proposed term in AS 1201) and "referred-to auditor;"
- Obtaining a representation from the referred-to auditor that the referred-to auditor is duly licensed to practice under the laws of the jurisdiction that apply to the referred-to auditor's work;

⁵⁵ See, e.g., AS 2101.11–.14, and AS 2105.10.



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- If the referred-to auditor would play a substantial role in the preparation or furnishing of the lead auditor's report, determining whether the referred-to auditor is registered pursuant to the rules of the PCAOB;
- Communicating the decision to divide responsibility for the audit with another public accounting firm and determining a course of action when the lead auditor is unable to divide responsibility; and
- Disclosing the name of the referred-to auditor in the lead auditor's report.

Consistent with AS 1205, in the divided-responsibility scenario, the proposed amendments would require that the engagement partner determine sufficiency of his or her firm's participation in the audit to serve as the lead auditor. As discussed above, the proposed amendments would incorporate into the Board's standard on planning the existing requirements for determining sufficiency of the firm's participation from AS 1205 (which would be superseded by the proposal), with certain modifications.

The remainder of this section details key provisions of the proposed new standard and disposition of certain existing requirements of AS 1205. The discussion is organized as follows:

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VII.A	Terminology and Objectives	A4-47
VII.B	Performing Procedures with Respect to the Audit of the Referred-to Auditor	A4-49
VII.C.	Making Reference in the Lead Auditor's Report to the Audit and Auditor's Report of the Referred-to Auditor	A4-55

A. Terminology and Objectives

See proposed paragraphs .02 and .A2 – .A3 of AS 1206 in Appendix 2

Currently, AS 1205 uses terms "principal auditor" and "other auditor" when referring to the auditor issuing the auditor's report on the consolidated financial statements (principal auditor) and the accounting firm for whose work the principal auditor assumes responsibility or to whose audit and report the principal auditor makes reference in the principal auditor's report (other auditor). Since proposed AS 1206 would apply to only to situations in which the auditor divides responsibility with another public



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accounting firm, the proposed standard would use and define the term "referred-to auditor" to distinguish the firms with which the lead auditor divides responsibility from the "other auditors" that would be supervised under AS 1201, as proposed to be amended.

Under the proposed new standard, the objectives of the lead auditor would be to:

- (i) communicate with the referred-to auditor and determine that audit procedures are properly performed, in coordination with the referred-to auditor, with respect to the consolidation or combination of accounts in the company's financial statements and
- (ii) make the necessary disclosures in the lead auditor's report. The proposed new standard would not change the lead auditor's or referred-to auditor's responsibilities under other PCAOB standards. Both the lead auditor and referred-to auditor are required to plan and perform their respective audits and issue audit opinions in accordance with PCAOB standards.

Comparison with Standards of Other Standard Setters

IAASB standards do not provide for an auditor to divide responsibility for the audit with another independent public accounting firm. Paragraph 11 of ISA 600 states that the auditor's report on the group financial statements shall not refer to a component auditor, unless required by law or regulation.

According to paragraph .08 of AU-C Section 600, certain requirements of AU-C Section 600 apply only when the auditor of the group financial statements is assuming responsibility for the work of component auditors. All other requirements in AU-C Section 600 apply to all audits of group financial statements.

Paragraph .25 of AU-C Section 600 does not allow for the reference to the audit of a component auditor in the auditor's report on the group financial statements unless:

- a. The group engagement partner has determined that the component auditor has performed an audit of the financial statements of the component in accordance with the relevant requirements of generally accepted auditing standards ("GAAS"); and
- b. The component auditor has issued an auditor's report that is not restricted as to use.

Unlike the requirements of the proposed AS 1206, paragraph .28d of AU-C Section 600 describes making reference to the audit of a component auditor in the



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auditor's report on the group financial statements when the component auditor's report does not state that the audit of the component's financial statements was prepared in accordance with GAAS or PCAOB standards.

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

1. Performing Procedures Regarding the Consolidation or Combination of the Financial Statements

See proposed paragraph .03 of AS 1206

Currently, AS 1205.10 requires that the principal auditor adopt appropriate measures to assure the coordination of his activities with those of the other auditor in order to achieve a proper review of matters affecting the consolidating or combining of accounts in the financial statements.

The proposed new standard would retain and strengthen the existing requirement. Under the proposal, the lead auditor would be required to 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 audited by the referred-to auditor into the company's financial statements. Matters affecting the consolidation or combination of the financial statements would typically include items that are not in the scope of the referred-to auditor's audit, for example, elimination of intercompany transactions with the business unit audited by the referred-to auditor.

2. Communicating the Plan to Divide Responsibility

See proposed paragraph .04 of AS 1206

To enhance the communication between the lead auditor and the referred-to auditor, the proposed new standard would establish a specific requirement to communicate to the referred-to auditor, in writing, the lead auditor's decision to divide responsibility for the audit with the referred-to auditor pursuant to the proposed new standard and other applicable PCAOB standards. Having been informed of the lead auditor's decision, the referred-to auditor would be able to take the necessary steps to ascertain the implications of participating in the audit of the company. For example,



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SEC rules require that the audit report prepared by the referred-to auditor be filed with the SEC.⁵⁶

3. *Requesting a Written Representation Regarding Independence and Licensing*

See proposed paragraph .05 of AS 1206

Currently, paragraph .06b of AS 2101 requires the auditor to determine compliance with independence and ethics requirements. In addition, for situations governed by AS 1205, paragraph .10 of AS 1205 requires the lead auditor ("principal auditor," as used in the terminology of AS 1205) to make inquiries concerning the other auditor's independence. According to AS 1205.10 these inquiries may include procedures such as obtaining a representation from the other auditor that the other auditor is independent.⁵⁷

Under PCAOB Rule 3520, *Auditor Independence*, all auditors involved in the audit (including the firm and personnel of the lead auditor and other auditors), must be independent of the audit client throughout the audit and professional engagement period. This requirement for the lead auditor and other auditors not only extends to the independence rules and standards of the PCAOB but also extends to the rules and regulations of the SEC under the federal securities laws.

The proposed new standard would strengthen the existing requirements in AS 1205 regarding the lead auditor's responsibilities with respect to the independence of the referred-to auditor. Specifically, the lead auditor would be required to request a written representation from the referred-to auditor that the referred-to auditor is in compliance with the independence and ethics requirements of the PCAOB and the SEC. AS 1205 does not address situations in which the other auditor (proposed term "referred-to auditor") is not licensed to issue an audit report in their country or to perform audit work in other countries. The proposed new standard would add a requirement for the lead auditor to verify, by written representation from the referred-to auditor, that the referred-to auditor is duly licensed to practice under the laws of the jurisdiction that apply to the work of the referred-to auditor.

⁵⁶ See Regulation S-X Rule 2-05.

⁵⁷ See AS 1205.10b.



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In certain situations, the lead auditor would be precluded from dividing responsibility with the referred-to auditor based on the information about the referred-to auditor's independence and licensing, as discussed below.

4. *Conditions That Should Be Met for the Lead Auditor to Divide Responsibility*

Under the existing provisions of AS 1205.11, the principal auditor should appropriately qualify or disclaim his or her opinion on the consolidated financial statements if the results of the principal auditor's work performed in accordance with AS 1205 lead the principal auditor to the conclusion that he or she can neither assume responsibility for the work of the other auditor nor divide responsibility for the audit with the other auditor.

The proposed new standard would describe, more specifically than AS 1205: (i) conditions that should be met for the lead auditor to divide responsibility with the referred-to auditor and (ii) the lead auditor's course of action when the lead auditor is unable to divide responsibility. The proposed requirements are designed to facilitate compliance with the ethics and independence requirements of the PCAOB and the SEC and with the Board's registration rules and to reduce the likelihood of filing with the SEC auditor's reports that violate any relevant local licensing requirements. These requirements are detailed below.

(i) *Performed an Audit and Issued an Auditor's Report in Accordance with PCAOB Standards*

See proposed paragraph .06a of AS 1206

According to paragraph .06a in the proposed new standard, the lead auditor may divide responsibility with another accounting firm only if the referred-to auditor has represented that it has performed an audit and issued an auditor's report in accordance with PCAOB standards.⁵⁸ This proposed provision, which is not included in AS 1205, is

⁵⁸ AS 3101 applies to auditors' reports issued in connection with 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 applies to auditors' reports issued in connection with audits of management's assessment of the effectiveness of internal control over financial reporting that is integrated with an audit of the financial statements.



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consistent with the existing SEC rules and guidance with respect to auditors' reports filed with the SEC.⁵⁹

(ii) Financial Reporting Framework Used to Prepare the Company's and Business Unit's Financial Statements

See proposed paragraph .06b of AS1206

According to paragraph .06b in the proposed new standard, the lead auditor may divide responsibility with another accounting firm only if the financial statements of the company's business unit audited by the referred-to auditor were prepared using the same financial reporting framework as the financial reporting framework used to prepare the company's financial statements. This proposed provision, which is not included in AS 1205, is consistent with the notion that the amounts in the financial statements reported on by the referred-to auditor are included without adjustment in the financial statements reported on by the lead auditor.

(iii) Knowledge of Relevant Requirements and Standards

See proposed paragraph .06c of AS 1206

Under the proposed new standard the lead auditor may divide responsibility with the referred-to auditor only if the lead auditor determines, based on inquiries made to the referred-to auditor and other information obtained by the lead auditor during the audit, that the referred-to auditor knows (*i.e.*, individuals who conduct the audit know) the relevant requirements of the applicable financial reporting framework, standards of the PCAOB, and financial reporting requirements of the SEC. Similar requirements are proposed in paragraph .B6 of AS 2101 and discussed in Section III.E.

Under the proposed new standard, for example, the lead auditor could interact with the referred-to auditor (*e.g.*, a teleconference) to discuss the referred-to auditor's prior and current work experience that may be relevant to evaluating the professional competence in the context of the engagement.

⁵⁹ See Regulation S-X Rule 2-02(b)(1) and SEC Release No. 34-49708, *Commission Guidance Regarding the Public Company Accounting Oversight Board's Auditing and Related Professional Practice Standard No. 1*.



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(iv) Ethics and Independence, Licensing, and Registration

See proposed paragraphs .06d(1), .06d(2), and .06e of AS 1206

Under the proposed new standard the lead auditor may divide responsibility with the referred-to auditor only if certain conditions are met regarding the referred-to auditor's: (i) compliance with ethics and independence requirements of the PCAOB and the SEC; (ii) licensing status under the laws of the jurisdiction of the referred-to auditor's principal office; and (iii) registration status with the PCAOB, when applicable. The proposed requirements are designed to increase the likelihood that the lead auditor divides responsibility with an appropriately qualified referred-to auditor.

(v) Lead Auditor's Course of Action

See proposed paragraph .07 of AS 1206

The proposed new standard also would describe, more specifically than AS 1205, the options available to the lead auditor in situations in which the lead auditor is unable to divide responsibility. According to the proposed new standard, the options available to the lead auditor in such situations are:

- Planning and performing procedures with respect to the portion of the company's financial statements covered by the other accounting firm's report that are necessary for the lead auditor to issue an opinion on the company's financial statements and, if applicable, internal control over financial reporting; or
- Qualifying or disclaiming the lead auditor's report (an option that is currently described in AS 1205); or
- Withdrawing from the engagement.

Similar to AS 1205, the proposed new standard would require the lead auditor to state the reasons for modifying the report 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.



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5. Comparison with Standards of Other Standard Setters

IAASB standards do not contain requirements for situations in which the auditor divides responsibility for the audit with another independent public accounting firm.

Paragraph .41 of AU-C Section 600 states that the group engagement team should communicate its requirements to a component auditor on a timely basis and that this communication should include, among other things, a request that the component auditor, knowing the context in which the group engagement team will use the work of the component auditor, confirm that the component auditor will cooperate with the group engagement team.

According to paragraph .22 of AU-C Section 600, the group engagement team should obtain an understanding of, among other things, whether a component auditor understands and will comply with the ethical requirements that are relevant to the group audit and, in particular, is independent.

Paragraph .23 of AU-C Section 600 states that, when a component auditor does not meet the independence requirements that are relevant to the group audit or the group engagement team has serious concerns about the other matters listed in paragraphs .22a–b of AU-C Section 600 (which are related to a component auditor's qualifications), the group engagement team should obtain sufficient appropriate audit evidence relating to the financial information of the component without making reference to the audit of that component auditor in the auditor's report on the group financial statements or otherwise using the work of that component auditor.

Paragraph .28 of AU-C Section 600 addresses situations in which an auditor's report on group financial statements makes reference to a component auditor when (1) the component's financial statements are prepared using a different financial reporting framework from that used for the group financial statements; or (2) the component auditor's work was performed under different auditing standards, and additional procedures are required to comply with GAAS.

Questions:

47. Are the objectives of the proposed new standard clear and appropriate? If not, what changes are necessary?



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48. Are the proposed requirements for performing procedures with respect to the audit of the referred-to auditor clear and appropriate? If not, what changes are necessary?
49. Are the conditions included in paragraph .06 of the proposed new standard clear and appropriate? Are there other conditions that should be met for the lead auditor to divide responsibility with a referred-to auditor?
50. Paragraph .07 of the proposed new standard describes the lead auditor's course of action in situations in which the lead auditor cannot divide responsibility. Are the requirements in this paragraph clear and appropriate? Why or why not? Are additional requirements necessary for such situations?
51. An unintended consequence of the Board's proposal, described earlier in this release, is the potential increase in the use of the divided responsibility model by auditors. Should the Board prohibit divided responsibility arrangements or impose further limitations on them, such as limiting them to equity method investees or situations in which the referred-to auditor covers only a small portion of the consolidated assets or operations? If so, what would be the costs and benefits of such a prohibition or limitation?

C. Making Reference in the Lead Auditor's Report to the Audit and Auditor's Report of the Referred-to Auditor

See proposed paragraphs .08, .09, and .B1 of AS 1206

1. Requirements for Making Reference

Paragraphs .08 and .09 of the proposed new standard would establish requirements for making reference in the lead auditor's report to the audit and auditor's report of the referred-to auditor in situations in which the responsibility for the audit is divided. Some of the proposed requirements should be familiar to auditors because they are based on the existing requirements in AS 1205. For example, similar to AS 1205, the proposed new standard would require that the lead auditor's report:

- Indicate clearly, in the introductory, scope, and opinion paragraphs, the division of responsibility between the portion of the company's financial



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statements and, if applicable, internal control over financial reporting, covered by the lead auditor's own audit and that covered by the audit of the referred-to auditor; and

- 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 (or by each of the referred-to auditors if there is more than one). 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 each of the referred-to auditors.

If the report of the referred-to auditor is other than a standard report, the proposed new standard, similar to AS 1205, would require that the lead auditor make reference to the departure from the standard report and its disposition in the lead auditor's report, unless the matter is clearly trivial to the company's financial statements.

2. Identifying the Referred-to Auditor by Name

To make the name of the referred-to auditor more readily available to investors and other users of the lead auditor's report, the proposed new standard would include a new requirement to identify the referred-to auditor by name in the lead auditor's report. SEC rules already include a requirement that the audit report of the referred-to auditor be filed with the SEC, so the name of the referred-to auditor is already made public.⁶⁰ Under AS 1205, the other auditor may be named only with its express permission and if its report is presented together with the lead auditor's report.⁶¹ According to the proposed new standard, the lead auditor's report should identify the referred-to auditor by name and refer to the report of the referred-to auditor when describing the scope of the audit and when expressing an opinion.

⁶⁰ See Rule 2-05 of Regulation S-X, 17 C.F.R. 210.2-05.

⁶¹ See AS 1205.07. The Board amended AS 1205.07 in PCAOB Release No. 2015-008, *Improving the Transparency of Audits: Rules to Require Disclosure of Certain Audit Participants on a New PCAOB Form and Related Amendments to Auditing Standards* (Dec. 15, 2015), which is subject to approval by the SEC. The amendments remove the requirement for the lead auditor to obtain the other auditor's express permission when deciding to disclose the other auditor's name in the lead auditor's report.



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3. Comparison with Standards of Other Standard Setters

IAASB standards do not contain requirements for situations in which the auditor divides responsibility for the audit with another independent public accounting firm.

Paragraph .28 of AU-C Section 600 requires that, when the group engagement partner decides to make reference to the audit of a component auditor in the auditor's report on the group financial statements, the report on the group financial statements clearly indicate, among other things:

- a. That the component was not audited by the auditor of the group financial statements but was audited by the component auditor; and
- b. The magnitude of the portion of the financial statements audited by the component auditor.

Unlike the proposed AS 1206, paragraph .29 of AU-C Section 600 requires that, among other things, if the group engagement partner decides to name a component auditor in the auditor's report on the group financial statements the component auditor's express permission should be obtained.

Paragraph .30 of AU-C Section 600 requires that, if the opinion of a component auditor is modified or if that report includes an emphasis-of-matter or other-matter paragraph, the auditor of the group financial statements determine the effect that this may have on the auditor's report on the group financial statements. When deemed appropriate, the auditor of the group financial statements should modify the opinion on the group financial statements or include an emphasis-of-matter paragraph or an other-matter paragraph in the auditor's report on the group financial statements.

Question:

52. Are additional requirements, including supervisory requirements, necessary to describe responsibilities of the lead auditor in situations in which the lead auditor divides responsibility for the audit with another accounting firm? Are there any other situations that would present challenges with the application of the proposed requirements?



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VIII. Other Considerations

A. **Proposal to Supersede AI 10 (currently AU sec. 9543, *Part of Audit Performed by Other Independent Auditors: Auditing Interpretations of Section 543*), Part of the Audit Performed by Other Independent Auditors: Auditing Interpretations of AS 1205**

The Board's proposal would supersede AI 10, which provides guidance for the lead auditor ("principal auditor," as used in the terminology of AS 1205) on certain matters involving the use of the work and reports of another accounting firm under AS 1205.⁶² Specifically, AI 10 addresses requesting the other accounting firm to perform specific procedures, responding to inquiries made by the accounting firm, and performing procedures when the principal auditor decides not to make reference to the audit of another accounting firm (see interpretations 1, 4, 5, and 6 of AI 10). AI 10 also provides guidance for the other accounting firm with respect to inquiring of the principal auditor as to matters that may be significant to the audit performed by the other accounting firm (see interpretations 2 and 3 of AI 10).

Because AS 1205 would be superseded by the Board's proposal, auditors would be required to follow the direction in AS 1201 in situations in which the lead auditor supervises the work of other auditors. As detailed earlier in this appendix, AS 1201 describes requirements for, among other things, informing engagement team members (including other auditors) of their responsibilities, reviewing their work, and determining the extent of supervision. Further, AS 1215 describes certain specific information that the office issuing the auditor's report is required to obtain, review, and retain with respect to the work performed by other auditors.

Situations in which the lead auditor divides responsibility for the audit with a referred-to auditor would be governed by the proposed new standard. The proposed new standard requires, among other things, that the lead auditor communicate with the referred-to auditor and determine that audit procedures are properly performed, in coordination with the referred-to auditor, with respect to the consolidation or

⁶² Currently, AS 1205 uses the terms "principal auditor" and "other auditor" to describe, respectively, the accounting firm issuing the auditor's report on the company's consolidated financial statements and the accounting firm for whose work the principal auditor assumes responsibility, or with whom the principal auditor divides responsibility, under AS 1205.



combination of the financial statements of the business units audited by the referred-to auditor into the company's financial statements.

The other accounting firm's inquiry of the lead auditor when the lead auditor supervises the work of the other accounting firm is addressed by existing standards. For example, auditors are required to apply due professional care.⁶³ This includes bringing to the attention of appropriate persons any concerns about significant accounting and auditing issues.⁶⁴ For situations in which the lead auditor divides responsibility for the audit with the other accounting firm, a proposed amendment to AS 2110 would carry forward, with modifications, the existing requirement in AI 10 for the referred-to auditor's inquiries of the lead auditor as to matters (e.g., executive compensation arrangements) that may be significant to the referred-to auditor's own audit.

Question:

53. Is superseding AI 10 appropriate, or is the interpretation necessary to fully describe the auditor's responsibilities under PCAOB standards?

B. Proposed Amendments Relating to Inquiries About Professional Reputation and Standing

Currently, in the context of making inquiries about the professional reputation and standing of an auditor whose audit report is used as audit evidence in the audit of a company's financial statement (such as the audit report of a service auditor or predecessor auditor), several existing provisions within PCAOB auditing standards refer to AS 1205.10 through .12 as relevant guidance for making such inquiries.⁶⁵ Today, in the majority of these circumstances, the auditor whose report is used in this manner is

⁶³ See generally AS 1015.

⁶⁴ See, e.g., AS 1201.05b.

⁶⁵ See, e.g., paragraph .28 of AS 2503 (currently AU sec 332), *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*, paragraphs .18–.19 of AS 2601, *Consideration of an Entity's Use of a Service Organization* (currently AU sec. 324, *Service Organizations*), and footnote 8 to paragraph .12 of AS 2610, *Initial Audits—Communications Between Predecessor and Successor Auditors* (currently AU sec. 315, *Communications Between Predecessor and Successor Auditors*).



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neither supervised by the lead auditor in accordance with AS 1201 nor serving as another independent auditor under AS 1205.⁶⁶

Because the Board's proposal would supersede AS 1205, the other proposed amendments would incorporate the provisions of AS 1205.10 through .12 into the text of the auditing standards that currently refer to it with minor modifications to conform to the specific issue addressed by each provision amended and the Board's proposal generally.

Question:

54. Are the other proposed amendments relating to inquiries about professional reputation and standing of other auditors appropriate and clear in the context of each requirement? If not, what further amendments should the Board consider making to this requirement to improve its clarity?

C. Certain Existing Requirements of AS 1205—Discussion of Remaining Requirements Not Specifically Addressed in the Proposed New Standard

Sufficiency of participation. Currently, for situations in which AS 1205 applies, paragraph .02 of the standard describes requirements for determining the sufficiency of a firm's participation in an audit to serve as lead auditor ("principal auditor," as used in the terminology of AS 1205.) As discussed earlier in this release, under the proposed amendments, the sufficiency determination requirements would be included in Appendix B of AS 2101, and the auditor would be required to apply the requirements when other auditors are involved in the audit, including in situations when the lead auditor divides responsibility for the audit with the referred-to auditor. The proposed new standard would reference the relevant proposed requirements in AS 2101.⁶⁷

Situations involving reporting under equity and cost methods of accounting. Currently, AS 1205.14 includes a discussion of whether the auditor is in the position of a principal auditor and whether the auditor may refer to the work and report of the

⁶⁶ For these circumstances the auditor who uses the audit may be in a position analogous to that of a principal auditor. See, e.g., AS 1205.14.

⁶⁷ See the first note to paragraph .01 of the proposed new standard.



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referred-to auditor in situations in which another auditor performs work and issues a report on the financial statements of a part of the company for which the company accounts under either the equity method or cost method of accounting.

With this proposal, the Board seeks neither to expand or narrow the range of situations involving other auditors currently covered by AS 1205 and AS 1201. Rather, the proposal seeks to update and improve the requirements governing the lead auditor's involvement with other auditors within the existing range of situations covered by those standards.

With respect to investments accounted for under the equity method that are selected for testing pursuant to AS 2101,⁶⁸ AS 1201, as proposed to be amended, would apply when the investor's equity in the underlying net assets and its share of the earnings or losses of the investee are recorded based on investee financial statements that are audited by an auditor other than the lead auditor, unless the lead auditor divides responsibility with the auditor of the investee, in which case proposed AS 1206 would apply. This is consistent with the principle currently set forth in AS 1205.14.

Situations involving pooling-of-interest transactions. The proposed new standard does not retain the provisions in AS 1205.16 regarding reporting on restated financial statements following a pooling-of-interest transaction because the pooling-of-interest method of accounting is no longer allowed for business combinations under either U.S. generally accepted accounting principles or International Financial Reporting Standards.

IX. Additional Questions Regarding Certain Aspects of the Proposal

Appendix 3 contains additional amendments that the Board is proposing to conform its standards to the proposed amendments to AS 1201, AS 1215, AS 1220, and AS 2101. The proposed conforming amendments are not intended to change the meaning of existing requirements. The Board invites comments on the amendments included in Appendix 3. The following are specific questions on the proposed amendments included in Appendix 3 and more general questions on the overall proposal:

⁶⁸ See AS 2101.11 through .14, which set forth requirements for determining locations or business units at which audit procedures should be performed.



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55. Are the proposed conforming amendments in Appendix 3 appropriate and clear? Why or why not? What changes to the amendments are necessary?
56. In addition to the proposed conforming amendments in Appendix 3, are other conforming amendments necessary in connection with the proposed changes to AS 1201, AS 1215, AS 1220, and AS 2101?
57. Paragraph .10d of AS 1301 (currently Auditing Standard No. 16), *Communications with Audit Committees*, describes requirements regarding the lead auditor's communication to the audit committee of certain information about the other auditors. Should the lead auditor's communication to the audit committee with respect to the lead auditor's or other auditors' responsibilities in an audit be more specific than is currently required? If so, what additional information should the lead auditor communicate?
58. Because the Board's proposal focuses on audit engagements, it does not include amendments for engagements other than audits. Should the proposal include changes for reviews of interim financial information under AS 4105, *Reviews of Interim Financial Information* (currently AU sec. 722, *Interim Financial Information*) that involve "other auditors" or "referred-to auditors" (as proposed to be defined)? If so, what additional changes are needed?
59. Is it sufficiently clear when AS 1201 (as proposed to be amended) or proposed AS 1206 – as opposed to AS 2503 – would apply to an audit of a company's equity method investment or other investments in an entity whose financial statements are audited by another accounting firm? If not, what change or guidance is needed?



APPENDIX 5

Characteristics of Self-Identified Emerging Growth Companies

The PCAOB has been monitoring implementation of the Jumpstart Our Business Startups Act ("JOBS Act") in order to understand the characteristics of EGCs¹ and inform the Board's consideration of whether it should request that the SEC apply the proposed amendments to audits of EGCs. To assist commenters, the Board is providing the following information regarding EGCs that it has compiled from public sources.²

As of November 15, 2015, based on the PCAOB's research, there were 2,229 companies that had filed audited financial statements and identified themselves as EGCs in at least one SEC filing. Among the 2,229 EGCs, there were 259 that did not file audited financial statements within the 18 months preceding November 15, 2015.³

¹ Pursuant to the JOBS Act, an EGC is defined in Section 3(a)(80) of the Securities Exchange Act of 1934 ("Exchange Act"). In general terms, an issuer qualifies as an EGC if it has total annual gross revenue of less than \$1 billion during its most recently completed fiscal year and its first sale of common equity securities pursuant to an effective registration statement under the Securities Act of 1933 ("Securities Act") did not occur on or before December 8, 2011. See JOBS Act Section 101(a), (b), and (d). An issuer retains its EGC status until the earliest of: (i) the first year after it has total annual gross revenue of \$1 billion or more (as indexed for inflation every five years by the SEC); (ii) the end of the fiscal year after the fifth anniversary of its first sale of common equity securities under an effective Securities Act registration statement; (iii) the date on which the company issues more than \$1 billion in non-convertible debt during the prior three year period; or (iv) the date on which it is deemed to be a "large accelerated filer" under the Exchange Act (generally, an entity that has been public for at least one year and has an equity float of at least \$700 million).

² The staff of the PCAOB's Office of Research and Analysis identified the population of EGCs using Audit Analytics data on companies that, as of the calculation date, self-identified as EGCs in SEC filings. The data excludes companies that, as of the calculation date, had (i) terminated their Exchange Act registration, (ii) had their Exchange Act registration revoked, or (iii) withdrawn their registration statement before effectiveness and, in each case, did not subsequently file audited financial statements with the SEC. It also excludes companies that reported more than \$1 billion in annual revenues or self-identified as a large accelerated filer. PCAOB staff has not otherwise attempted to validate these companies' self-identification as EGCs.

³ Approximately 24 percent of these 259 companies are blank check companies according to the Standard Industrial Classification ("SIC") code. This is the most common SIC code among the 259 companies; the next most common SIC code (6 percent) is that for metal mining. The remaining SIC codes each represent less than 5



Because of lack of current data regarding these 259 companies, the information below focuses on the remaining 1,970 companies that filed audited financial statements with the SEC in the 18 months preceding November 15, 2015.

General Characteristics

These companies operate in diverse industries. The five most common SIC codes applicable to these companies are: (i) pharmaceutical preparations; (ii) blank check companies; (iii) real estate investment trusts; (iv) prepackaged software services; and (v) computer processing and data preparation.

The five SIC codes with the highest total assets as a percentage of the total assets of the population of EGCs are codes for: (i) real estate investment trusts; (ii) state commercial banks; (iii) crude petroleum or natural gas; (iv) national commercial banks; and (v) pharmaceutical preparations. Total assets of EGCs in these five SIC codes represent approximately 45 percent of the total assets of the population of EGCs. EGCs in two of these five SIC codes (state commercial banks and national commercial banks) represent financial institutions, and the total assets for these two SIC codes represent approximately 17 percent of the total assets of the population of EGCs.

Approximately 14 percent of the EGCs had identified themselves in Securities Act registration statements and had not reported under the Exchange Act as of November 15, 2015. Approximately 74 percent of EGCs began reporting under the Exchange Act in 2012 or later. The remaining 12 percent of these companies have been reporting under the Exchange Act since 2011 or earlier.

Approximately 56 percent of EGCs that filed an Exchange Act filing indicated that they were smaller reporting companies.⁴

percent. Approximately 80 percent of these 259 companies had an explanatory paragraph included in the last auditor's report filed with the SEC stating that there is substantial doubt about the company's ability to continue as a going concern. Approximately 10 percent of these 259 companies were audited by firms that were annually inspected firms in 2015 and 90 percent of these 259 companies were audited by firms that are subject to inspection at least every three years by the PCAOB, containing U.S. firms (85 percent), firms that are non-U.S. affiliates of annually inspected firms in 2015 (3 percent), and other non-U.S. firms (2 percent).

⁴ The SEC adopted its current smaller reporting company rules in *Smaller Reporting Company Regulatory Relief and Simplification*, Securities Act Release No. 33-8876 (Dec. 19, 2007). Generally, companies qualify to be smaller reporting companies and, therefore, have scaled disclosure requirements if they have less than \$75 million in public equity float. Companies without a calculable public equity float will



Approximately 41 percent (802) of the 1,970 EGCs have common equity securities listed on a U.S. national securities exchange ("publicly listed EGCs").⁵ These EGCs represent approximately 16 percent of all publicly listed companies and approximately 1 percent of the total market capitalization of publicly listed companies.

Financial Data

The information in this section is derived from the most recent audited financial statements filed as of November 15, 2015 for the 1,970 EGCs. The descriptions in this section also include tabular information for all EGCs, EGCs that are not publicly listed ("non-listed EGCs"), and publicly listed EGCs. To enable comparison of publicly listed EGCs with the broader public equity market, the information also includes data about the other publicly listed companies.

Assets. The reported assets of all EGCs ranged from zero to approximately \$12.9 billion. The average and median reported assets were approximately \$223 million and \$3.4 million, respectively. Publicly listed EGCs had significantly higher average and median assets (approximately \$468 million and \$141 million, respectively) as compared to non-listed EGCs (approximately \$55 million and \$100,000, respectively). Other publicly listed companies had even higher average and median assets (approximately \$18.5 billion and \$1.3 billion, respectively).

qualify if their annual revenues were less than \$50 million during the most recently completed fiscal year for which audited financial statements are available. Scaled disclosure requirements generally reduce the compliance burden of smaller reporting companies compared to other issuers.

⁵ To compare the publicly listed EGC population with the broader public equity market, the PCAOB compared the data compiled with respect to the population of companies that identified themselves as EGCs with a benchmark derived from data from Standard & Poor's on companies that have at least one class of common equity securities (common-ordinaries, units with a common share component, and depository receipts) listed on a U.S. national securities exchange. The benchmark population is limited to companies that are not investment companies and that, according to Audit Analytics data, have filed audited financial statements with the SEC in the 18 months preceding the calculation date. From a total population of 5,119 such companies, the 802 publicly listed EGCs are excluded to avoid double counting. Using this methodology, PCAOB staff identified 4,317 companies in the benchmark population (referred to as "other publicly listed companies") as of November 15, 2015.

Reported Assets (\$ millions)	<u>All EGCs</u>	<u>Non-listed EGCs</u>	<u>Publicly Listed EGCs</u>	<u>Other Publicly Listed Companies</u>
Minimum	0	0	0	0
Maximum	12,859.4	12,859.4	9,798.7	2,634,139.0
Average	223.0	54.6	468.3	18,486.8
Median	3.4	0.1	141.4	1,299.2

Revenues. The reported revenues ranged from zero to approximately \$926 million. The average and median reported revenue were approximately \$55 million and \$81,000, respectively. Publicly listed EGCs had significantly higher average and median revenues (approximately \$118 million and \$33 million, respectively) as compared to non-listed EGCs (approximately \$12 million and \$0, respectively). Other publicly listed companies had even higher average and median revenues (approximately \$ 5.1 billion and \$580 million, respectively).

Reported Revenues (\$ millions)	<u>All EGCs</u>	<u>Non-listed EGCs</u>	<u>Publicly Listed EGCs</u>	<u>Other Publicly Listed Companies</u>
Minimum	0	0	0	0
Maximum	926.4	910.2	926.4	485,651.0
Average	54.9	11.5	118.2	5,124.2
Median	0.081	0	33.2	579.6

Companies Reporting Zero Revenues. The table below provides information about the percentage of all EGCs and the other categories of companies that reported zero revenues.

	<u>All EGCs</u>	<u>Non-listed EGCs</u>	<u>Publicly Listed EGCs</u>	<u>Other Publicly Listed Companies</u>
Companies Reporting Zero Revenues	42%	56%	21%	2%

Companies Reporting Revenues Greater than Zero. The table below provides information about the percentage of all EGCs and the other categories of companies that reported revenues greater than zero.

	<u>All EGCs</u>	<u>Non-listed EGCs</u>	<u>Publicly Listed EGCs</u>	<u>Other Publicly Listed Companies</u>
Companies Reporting Revenues Greater than Zero	58%	44%	79%	98%

The average reported assets and revenues of EGCs that reported revenues greater than zero were approximately \$371 million and \$94 million, respectively. Publicly listed EGCs had significantly higher average assets and revenues (approximately \$573 million and \$149 million, respectively) as compared to non-listed EGCs (approximately \$121 million and \$26 million, respectively). Other publicly listed companies had even higher average assets and revenues (approximately \$ 18.9 billion and \$5.2 billion, respectively).

<u>Reported Assets and Revenues (\$ millions)</u>	<u>All EGCs</u>	<u>Non-listed EGCs</u>	<u>Publicly Listed EGCs</u>	<u>Other Publicly Listed Companies</u>
<u>Assets</u>				
Minimum	0	0	0	0
Maximum	12,859.4	12,859.4	9,798.7	2,634,139.0
Average	370.8	121.4	573.3	18,889.6
Median	71.0	1.1	200.8	1,371.7
<u>Revenues</u>				
Minimum	0.00002	0.00002	0.00391	0.002
Maximum	926.4	910.2	926.4	485,651.0
Average	93.9	25.9	149.0	5,237.0
Median	12.7	0.5	67.2	602.9

Geographic Segment Reporting

The most recent audited financial statements filed in the 18 months preceding⁶ November 15, 2015 for those companies that identified as EGCs indicated that approximately 16 percent of the EGCs reported segment sales and assets⁷ in geographic areas outside the country or region of the accounting firm issuing the auditor's report.⁸ For these EGCs, on average, 59 percent and 67 percent of the reported segment sales and assets, respectively, were in geographic areas outside the country or region of the accounting firm issuing the auditor's report.⁹

Management Reporting on ICFR

Generally, EGC management is required to report on the effectiveness of internal control over financial reporting ("ICFR"), although auditor attestation is not required.¹⁰ Approximately 50 percent of the 1,970 EGC companies provided a management report on ICFR. Of those companies that provided a management report, approximately 53 percent stated in the report that the company's ICFR was not effective. Publicly listed EGCs reported material weaknesses at a significantly lower rate (14 percent) as compared to non-listed EGCs (71 percent). Other publicly listed companies reported material weaknesses at an even lower rate (7 percent).

⁶ An additional 259 entities identified as EGCs and did not file audited financial statements within the preceding 18 months.

⁷ See FASB Accounting Standards Codification, Topic 280, *Segment Reporting*.

⁸ Approximately 50 percent and 40 percent of the population of publicly listed companies that are not EGCs reported segment sales and assets, respectively, in geographic areas outside the country or region of the accounting firm issuing the auditor's report.

⁹ For the population of publicly listed companies that are not EGCs that reported segment sales or assets in geographic areas outside the country or region of the accounting firm issuing the auditor's report, approximately 45 percent and 38 percent of those segment sales and assets, respectively, were in geographic areas outside the country or region of the accounting firm issuing the auditor's report.

¹⁰ The management report on ICFR is required in annual reports, starting with the second annual report filed by the company. See Instruction 1 to Item 308(a) of Regulation S-K. EGCs that have not yet filed at least one annual report are therefore not required to provide it. EGCs are exempt from the requirement for auditor attestation of ICFR. See Section 404(b) of the Sarbanes-Oxley Act.



<u>ICFR Reporting</u>	<u>All EGCs</u>	<u>Non-listed EGCs</u>	<u>Publicly Listed EGCs</u>	<u>Other Publicly Listed Companies</u>
Number of Companies	1,970	1,168	802	4,317
Companies with Management ICFR Report	993 (50%)	680 (58%)	313 (39%)	4,157 (96%)
Material Weakness in ICFR Noted by Management	525 (53%)	480 (71%)	45 (14%)	284 (7%)

Auditors

Approximately 39 percent of EGCs were audited by firms that were annually inspected in 2015 and 61 percent of EGCs were audited by firms that are subject to inspection at least every three years by the PCAOB, containing U.S. firms (48 percent), firms that are non-U.S. affiliates of annually inspected firms in 2015 (9 percent), other non-U.S. firms (4 percent).

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Appendices

1. Revisions to the 2016 Proposed Amendments Relating to the Performance of Audits Involving Other Auditors and Proposed Standard for Audits Involving Referred-to Auditors
2. Cumulative Potential Amendments to Existing PCAOB Standards Relating to the Performance of Audits Involving Other Auditors (i.e., amendments proposed in 2016 modified for the revisions presented in this supplemental request for comment)
3. Proposed AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm* (modified for the revisions presented in this supplemental request for comment)

I. Overview

On April 12, 2016, the Board issued proposed amendments to PCAOB standards and a proposed standard ("2016 Proposal"¹) to strengthen requirements that apply to audits involving accounting firms and individual accountants outside the accounting firm that issues the audit report ("other auditors").² The proposed new standard would apply when the firm issuing the audit report ("lead auditor") divides responsibility for an audit with another accounting firm ("referred-to auditor") and refers to the audit report of the other firm in the lead auditor's own audit report. The 2016 Proposal, described in greater detail in Section II.B below, is intended to increase the involvement by the lead auditor in the work of other auditors, enhance the ability of the lead auditor to prevent or detect deficiencies in the work of other auditors, and facilitate improvements in the quality of the work of other auditors.

The Board received comments on the 2016 Proposal through comment letters as well as through discussions of the PCAOB's Standing Advisory Group ("SAG") that occurred in 2016 and 2017. Commenters generally supported the Board's objective of improving the quality of audits involving other auditors. Some commenters, including those who supported the overall direction of the proposal, 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.

The Board, in light of the views and information contained in comments on the 2016 Proposal, is considering for adoption certain revisions to the amendments it proposed in 2016. This supplemental request for comment (i) discusses significant comments received on the 2016 Proposal, (ii) presents the revisions to the proposed amendments that the Board is considering for adoption (described as "considering revising" or "considering revisions" throughout this release), and (iii) requests comment on those revisions and related matters. The Board also is reopening the comment

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). Readers may find it useful to refer to the 2016 Proposal when reading this supplemental request for comment.

² This release uses general meanings of "lead auditor" and "other auditors" for ease of explanation. The text of proposed amendments to standards in Appendices 1 through 3 includes more specific definitions of the terms for purposes of applying certain PCAOB standards. For example, the proposed amendments specifically exclude a "referred-to auditor" from the definition of "other auditors." See, e.g., proposed paragraphs .A5 and .A6 of AS 2101, *Audit Planning* (defining "other auditor" and "referred-to auditor"). See also the 2016 Proposal at 4, note 1.

period for the 2016 Proposal for any additional comments from the public on any other aspects of the 2016 Proposal.

II. Background

A. Audits Involving Other Auditors

As discussed in the 2016 Proposal, audits of many international companies include work that is performed by accountants other than the firm issuing the audit report. The work of other auditors may account for a significant share of the audit and may involve areas of high risk of material misstatement. It is important for investor protection that the lead auditor assure the audit involving other auditors is performed in accordance with PCAOB standards and that sufficient appropriate evidence is obtained through the work of the lead auditor and other auditors to support the lead auditor's opinion in the audit report.³

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.⁴ Over the past several years, PCAOB oversight activities have identified significant audit deficiencies relating to the work performed by other auditors and the lead auditor's role in the audit.⁵

To address challenges posed by the other auditors' involvement, some accounting firms in recent years changed how they supervise other auditors. These changes appear to have contributed to improvements in the quality of work performed by other auditors. Other firms, however, have not significantly changed 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.⁶

B. The 2016 Proposal

The 2016 Proposal is designed to strengthen the existing requirements and impose a more uniform approach to the lead auditor's supervision of other auditors. The proposed amendments and proposed standard are intended to increase the lead

³ See Section II of the 2016 Proposal.

⁴ The 2016 Proposal also addresses matters relating to the coordination of activities between the lead auditor and referred-to auditor in audits when the lead auditor divides responsibility.

⁵ See Sections II.B.2(i) and II.B.2(ii) of the 2016 Proposal.

⁶ See Sections II.B.2(iv) and II.C of the 2016 Proposal.

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.

Currently, two PCAOB standards – AS 1201, *Supervision of the Audit Engagement*, and AS 1205, *Part of the Audit Performed by Other Independent Auditors* – take different approaches to how the lead auditor supervises, or uses, the work of other auditors. AS 1201 sets forth the primary requirements for the supervision of the audit engagement, including supervising the work of engagement team members. In contrast, AS 1205 allows the lead auditor, under certain conditions, to use the results of the other auditor's work after performing specified, but limited, procedures.

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

- *Supersede AS 1205, Part of the Audit Performed by Other Independent Auditors.* Superseding AS 1205 would eliminate the lead auditor's ability to use the "work and reports" of other auditors under that standard. Instead, the lead auditor would be required either to (i) supervise the other auditors' work under AS 1201 when the lead auditor assumes responsibility for that work, or (ii) comply with proposed AS 1206 when the lead auditor divides responsibility for the audit with another accounting firm.
- *Amend AS 1201, Supervision of the Audit Engagement.* The 2016 Proposal would amend AS 1201 to provide additional direction to the lead auditor on how to apply the principles-based provisions of AS 1201 to supervision of other auditors. Specifically, the proposed amendments would require certain procedures to be performed by the lead auditor with respect to the supervision of the other auditors' work. Under the 2016 Proposal, the lead auditor would remain responsible for the supervision of the entire audit.
- *Amend AS 2101, Audit Planning.* The 2016 Proposal includes a number of amendments to AS 2101. In general, these amendments incorporate and update certain requirements from AS 1205 (which is proposed to be superseded), and amend certain existing requirements to specify that they be performed by the lead auditor. For example, the 2016 Proposal would enhance the requirement governing the lead auditor's assessment of whether it performs sufficient work on the audit to warrant serving as lead auditor.
- *Amend AS 1215, Audit Documentation.* The 2016 Proposal would amend the requirement in AS 1215 regarding the documentation to be obtained,

reviewed, and retained by the office of the firm issuing the auditor's report when other offices of the firm or other auditors are involved in the audit.

- Amend AS 1220, *Engagement Quality Review*. The 2016 Proposal includes an amendment to AS 1220, which would specifically require the engagement quality reviewer, in an audit involving other auditors or referred-to auditors, to evaluate the engagement partner's determination of his or her firm's sufficiency of participation in the audit.
- Provide 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 that apply when the lead auditor divides responsibility with another accounting firm under AS 1205 (which would be superseded). The new standard also would establish certain new requirements.
- Include definitions of "engagement team," "lead auditor," "other auditor," and "referred-to auditor," to operationalize the proposed requirements.

C. Comments on the 2016 Proposal

The PCAOB received 23 comment letters on the 2016 Proposal. In addition, the Board devoted two sessions of its SAG meetings in May and December of 2016 to the discussion of matters relating to the proposal. Matters relating to the proposal were also discussed in the May 2017 SAG meeting.

Commenters generally supported the Board's objective of improving the quality of audits involving other auditors. In particular, a number of commenters supported the Board's consideration of a scalable, risk-based approach to the supervision of other auditors' work. Most commenters also agreed with retaining an option (currently in PCAOB standards) for the lead auditor to divide the responsibility for the audit with another accounting firm.

A number of commenters, however, identified matters that, in their view, would require modification or clarification, principally related to the following subjects in the 2016 Proposal:

- Planning, including the sufficiency of lead auditor's participation and other auditors' qualifications;
- Supervision, including the communication between auditors and supervision of multiple tiers of other auditors;
- Division of responsibility, including situations that involve differing financial reporting frameworks;

- Documentation, including the documentation of the lead auditor's review;
- Engagement quality review; and
- Definitions.

After analyzing comments on the 2016 Proposal, the Board is considering for adoption certain revisions to the amendments to PCAOB auditing standards it proposed in 2016.

D. Purpose of the Supplemental Request for Comment

This supplemental request for comment (i) discusses significant comments received on the 2016 Proposal, (ii) presents the revisions to the proposed amendments that the Board is considering for adoption, and (iii) requests comment on those revisions and related matters.

Appendix 1 contains the text of revisions to the 2016 Proposal the Board is considering for adoption. Appendix 2 contains the same text of revisions (other than the proposed new standard, AS 1206), shown as cumulative proposed amendments to existing PCAOB standards. Appendix 2 thus shows the amendments proposed in 2016, modified for the revisions to those amendments that the Board is considering for adoption. Appendix 3 contains the proposed new standard, AS 1206, including revisions that the Board is considering for adoption.

This release contains questions on proposed rule text and other matters on which the Board is seeking comment. Readers are encouraged to answer the questions and also to comment on any aspect of the release or amendments not covered by specific questions. In addition, the Board continues to consider for adoption proposed amendments in the 2016 Proposal that are not discussed in this release. The Board is therefore reopening the comment period for the 2016 Proposal for any additional comments on any aspects of the 2016 Proposal. For all comments submitted, commenters are encouraged to provide reasoning to support their views and any data relevant to their comments.⁷

⁷ 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>.

III. Comments on and Revisions to the 2016 Proposal

A. Audit Planning

1. Determination to Serve as Lead Auditor (Sufficiency of Participation)

See proposed paragraph .B2 of AS 2101 on p. A1-2 in Appendix 1

The 2016 Proposal would require the engagement partner to determine whether his or her firm's participation in the audit is sufficient for the firm to serve as lead auditor. As proposed, the engagement partner would need to take into account the risks of material misstatement associated with the portions of the financial statements audited by the firm, relative to those portions audited by other auditors and referred-to auditors. The 2016 Proposal would extend this requirement to all audits involving other accounting firms, not merely those covered by existing AS 1205.⁸

Some commenters sought clarification regarding the 2016 Proposal's sufficiency of participation requirement. They asked whether the proposal would require the engagement partner to compare the work of his or her firm to each other auditor singly or to all other auditors in the aggregate, when evaluating whether his or her firm's participation in the audit is sufficient for the firm to serve as lead auditor.

Other commenters expressed concerns that the criterion in the 2016 Proposal regarding the risks of material misstatement was primarily quantitative and too narrow, and that in certain situations the proposed requirement for sufficiency determination may pose practical challenges. Some of those commenters said that sometimes the auditor best positioned to serve as lead auditor might not meet the proposed criterion, for example, if the lead auditor audited only the corporate headquarters and other auditors audited the company's operating units. Commenters also suggested modifications to the proposed requirements for determining sufficiency of participation, including additional criteria to be considered, for example: company characteristics such as legal domicile, location of the company's books and records or key decision-makers, legal jurisdiction of the company headquarters; and audit firm factors, such as where the firm is licensed, knowledge of the other participating audit firms, and existence of relevant network affiliations. Additionally, a few commenters suggested allowing the lead auditor's close supervision of another auditor to count toward the lead auditor's participation for purposes of the assessment.

⁸ The existing requirement regarding the sufficiency of participation in paragraph .02 of AS 1205 (which would be superseded by this release) applies only to audits covered by AS 1205.

After considering commenters' views, the Board has preliminarily concluded that the engagement partner of the prospective lead auditor should, when assessing his or her firm's sufficiency of participation in the audit, expressly take into account the importance to the company's financial statements of the locations where the firm performs its work. Therefore, the Board is considering revising the provisions for assessing a prospective lead auditor's sufficiency of participation to expressly require consideration of the importance of the locations or business units audited by the lead auditor. Specifically, the lead auditor would be required to consider both (i) the risks of material misstatement associated with the portion of the financial statements audited by the lead auditor (which was proposed),⁹ and (ii) the importance of the locations or business units for which the lead auditor performs procedures, in relation to the financial statements of the company as a whole, taking into account quantitative and qualitative factors (an additional consideration). Including importance as an additional consideration would more expressly address circumstances where, for example, the lead auditor audits the locations or business units where the primary financial reporting decisions are made and consolidated financial statements are prepared, even though they might not comprise a significant portion of the company's operations.¹⁰ Notably, the importance consideration is similar to an existing factor in AS 1205.¹¹ Under this requirement, the engagement partner would compare the lead auditor's portion of the audit to the portions audited by each other auditor or referred-to auditor singly, not in the aggregate.¹²

Additionally, in light of commenters' views that the number of divided responsibility engagements may increase,¹³ the Board is considering adding another

⁹ The 2016 Proposal includes a specific reference to materiality that, as proposed to be revised, would be encompassed by the qualitative and quantitative factors to be considered under the criterion on importance.

¹⁰ The 2016 Proposal presented examples of the application of the sufficiency of participation criteria. This revision to the requirement would not alter the conclusion in those examples; it would merely give more prominence to the consideration of the importance of locations and business units in the analysis of those examples.

¹¹ One of the criteria provided in AS 1205.02 is "the importance of the components [the auditor] audited in relation to the enterprise as a whole."

¹² The process under the expanded requirement of taking into account specified considerations and making comparisons to other firms singly is similar to the process under AS 1205, although the specified considerations would differ.

¹³ Based on PCAOB staff analysis of SEC filings as of August 3, 2017, Form 10-K filings showed approximately 33 and 43 audits in which the lead auditor divided responsibility with another auditor in fiscal years 2016 and 2015, respectively;

sufficiency threshold to be met by the lead auditor in prospective divided responsibility engagements, along with the criteria discussed above. Specifically, the Board is considering including a sufficiency criterion as follows:¹⁴

[T]he participation of the engagement partner's firm to serve as lead auditor ordinarily is not sufficient if the referred-to auditors, in aggregate, audit more than 50 percent of the company's assets or revenues.

This additional threshold is intended to reduce the likelihood that the lead auditor, who issues the audit report on a company's consolidated financial statements, would divide responsibility with an audit firm (or firms) that audits a majority of the company's assets or revenue.

This additional threshold for divided responsibility engagements is analogous to a quantitative threshold that appears in staff guidance set forth in the Financial Reporting Manual of the Securities and Exchange Commission ("SEC") Division of Corporation Finance.¹⁵ Including this threshold would reflect practice that has long been adopted by the profession.

This threshold is not a bright-line test, but instead would create a presumption that the lead auditor will not divide responsibility with an audit firm (or firms) that audits a majority of the company's assets or revenue.¹⁶ In the exceptional situations where a firm could overcome the presumption and serve as lead auditor, the firm would need to document why its participation in the audit was sufficient to do so, including how it satisfied the criteria based on the importance of the locations or business units it audited and risk of material misstatement associated with the portion of the company's financial statements that it audited. Examples of situations where this might arise

Form 20-F filings showed approximately 15 and 16 such audits in fiscal years 2016 and 2015, respectively.

¹⁴ Section III.C of this release discusses further conditions to be met in order to divide responsibility with another accounting firm.

¹⁵ The Division of Corporation Finance's Financial Reporting Manual provides that a lead auditor is generally expected to have audited or assumed responsibility for at least 50 percent of the assets and revenues of the consolidated entity. See SEC, Division of Corporation Finance, Financial Reporting Manual, Section 4140.1.

¹⁶ Notably, while the comparison based on the importance of the locations or business units and risk of material misstatement associated with the portion of the financial statements is made singly, the additional threshold based on assets and revenue is made for all referred-to auditors in the aggregate.

include, but are not limited to, significant late-year acquisitions or other unanticipated events or conditions that increase the portion of assets or revenue audited by referred-to auditors beyond the 50 percent threshold.

Finally, the Board considered, but has preliminarily rejected, including audit firm factors as criteria in the sufficiency determination (e.g., where the firm is licensed, the firm's knowledge of the other participating audit firms, and the existence of relevant network affiliations) because the sufficiency determination should be based on the work the auditor performed on the audit, rather than on the auditor's attributes. Also, the Board does not currently intend to change the requirement so that close supervision of other auditors' work by the lead auditor would count toward the lead auditor's participation, as suggested by some commenters. Creating separate categories of supervision, and treating the categories differently, would be inconsistent with an existing principle in AS 1201¹⁷ that the Board believes is appropriate to preserve – namely, that the extent of supervision should be based on specified factors such as the risk of material misstatement.

Questions:

1. Is the revised requirement for determining the sufficiency of participation to serve as lead auditor, based on risk and importance of the locations, appropriate and clear?
2. Is the additional sufficiency threshold for divided responsibility engagements clear? Should this be a bright-line requirement, or does this threshold need to allow for exceptional situations? Are there any other implications of this threshold that the Board should consider, such as investor protection implications or auditing challenges related to the revised requirement?

2. Other Auditors' Compliance with Independence and Ethics Requirements

See proposed paragraph .B4 of AS 2101 on p. A1-3 in Appendix 1

The 2016 Proposal would require, in audits that involve other auditors,¹⁸ that the lead auditor determine other auditors' compliance with the SEC's independence and the

¹⁷ See AS 1201.06 in Appendix 2 of this release.

¹⁸ See proposed AS 1206 in Appendix 3 of this release for the requirements with respect to obtaining representation regarding the referred-to auditor's compliance with SEC independence requirements and PCAOB independence and ethics requirements.

PCAOB's independence and ethics requirements by doing the following: (i) understanding each other auditor's knowledge of independence and ethics requirements and experience in applying the requirements, and (ii) obtaining a written representation from each other auditor that it is in compliance with independence and ethics requirements. The 2016 Proposal would build on existing requirements in PCAOB standards to determine compliance with independence and ethics requirements.¹⁹

Commenters generally agreed that understanding the qualifications (including independence and ethics) of the other auditor is important. Some commenters, however, questioned the practicability of applying the required procedures in the proposal to individual engagement team members. Some commenters asked whether the lead auditor would satisfy the proposed requirement by obtaining from a firm that serves as other auditor a representation that also encompasses all applicable persons at the firm. Some commenters suggested that the lead auditor should be allowed to rely on its network's quality control system when the other auditor and the lead auditor are in a common network.

After considering the comments, the Board is considering revisions to the proposed requirement. Specifically, the lead auditor would be required to understand the other auditor's²⁰ "process for determining compliance" with the independence and ethics requirements and experience in applying the requirements, rather than understand the other auditor's knowledge of the requirements. By focusing the lead auditor on the other auditor firm's process for determining compliance and its experience with the requirements, the lead auditor would be in a better position to identify matters that may warrant further attention, as compared to merely understanding the other auditor's knowledge of the requirements. For example, the lead auditor might become aware of gaps in the other auditor's process for identifying prohibited financial relationships of covered persons, and the lead auditor might ask the other auditor to ascertain whether independence violations might have occurred in that area.

Additionally, the Board is considering adding a requirement for the lead auditor to obtain a written description from each other auditor regarding all relationships between

¹⁹ See, e.g., AS 2101.06b in Appendix 2 of this release.

²⁰ The proposed definition of "other auditor" includes both a firm and individuals from that firm. As a practical matter, this requirement would typically be applied at the firm level because the other auditor firm would typically have both the processes for determining compliance with PCAOB independence and ethics requirements and SEC independence requirements and some level of experience in applying those requirements. This requirement would be applied at the individual level for participating persons who are not part of a firm.

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.²¹ This additional requirement would help reinforce and support the need for the lead auditor to receive information that is important to the lead auditor's determination of compliance with SEC and PCAOB independence requirements, and facilitate auditor communications under PCAOB Rule 3526, *Communication with Audit Committees Concerning Independence*.²²

The Board also is considering revising the description of the required representation from the other auditor to the lead auditor. As revised, the lead auditor would be required to obtain a representation from the other auditor "that it is, or is not, in compliance" with independence and ethics requirements, and if not in compliance, to obtain a description of the nature of any non-compliance. This revision would clarify the intent of the proposed representation requirement—to obtain confirmation that the other auditor is in compliance with the independence and ethics requirements or, in the alternative, an explanation of the nature of any non-compliance. The other auditor firm could make a written representation that encompasses all covered persons of that firm. Similarly, the other auditor firm's written description to the lead auditor regarding any relationships between the firm and the audit client or persons in financial reporting oversight roles at the audit client that may reasonably be thought to bear on independence could include the firm's covered persons. In both instances, obtaining from a firm a written representation or description that also encompasses relevant individuals at the firm, would satisfy the requirement to obtain a written representation or description "from each other auditor," for those persons at that firm.

Because of the wide variety of circumstances in which other auditors are used, the Board does not currently intend to prescribe how the lead auditor should gain an understanding of the other auditor's process for determining compliance with the independence and ethics requirements and experience in applying them. Rather, the lead auditor should determine the necessary procedures to obtain a sufficient understanding under the circumstances. For example, the lead auditor may obtain a written description of the other auditor's process and results of the process, or may obtain this understanding through inquiry, and perform follow-up procedures as necessary to address gaps in the process or indications of potential noncompliance.

²¹ 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."

²² Rule 3526 requires auditors 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."

Factors that may affect the necessary level of effort in obtaining the understanding of the other auditor's process and experience include the lead auditor's existing knowledge of the other auditor's process; the lead auditor's experience with the other auditor's past compliance with the ethics and independence requirements; changes in the other auditor's processes or circumstances that may affect the risk of non-compliance; and other information available to the auditor about the other auditor's practices or compliance with independence and ethics requirements.

Information obtained by the lead auditor about the other auditor could either support or contradict the other auditor's representation regarding compliance with independence and ethics requirements or the written description of 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. The following are possible examples of the types of information that might contradict or raise doubt about an assertion of compliance: lack of a process for identifying non-audit services provided to audit clients; previously undisclosed business relationships with audit clients; or violations identified by the other auditor or others (e.g., regulators) of the independence and ethics requirements. Relevant information about the other auditor may come either directly from the other auditor or from other sources, such as regulatory reports or news articles.

The Board has preliminarily decided not to allow "reliance" on a network in determining the other auditor's compliance with independence and ethics requirements, as some commenters suggested (i.e., the Board would retain the relevant 2016 amendments as proposed). Affiliation with the same network does not automatically provide the lead auditor with an understanding of the other affiliates' processes and experience. Although the lead auditor might be able to access more readily information about network affiliates than non-affiliated firms, the lead auditor remains responsible for obtaining the required understanding of the other auditors' processes for and experience with complying with independence and ethics requirements.²³

Question:

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

²³ See the discussion above regarding factors that may affect the necessary level of effort in obtaining the understanding of the other auditor's process and experience.

3. Other Auditors' Knowledge, Skill, and Ability

See proposed paragraph .B6 of AS 2101 on p. A1-4 in Appendix 1

The 2016 Proposal would require the lead auditor to understand the knowledge, skill, and ability of other auditors who assist the lead auditor in planning or supervising the audit.

Commenters generally supported this new requirement. Some commenters recommended requiring the lead auditor to understand the knowledge, skill, and ability of all of the engagement team members at the other auditor, not only those who assist with planning and supervision. Some commenters also suggested requiring the lead auditor to consider indirect information about the other auditor, such as past experience with the other auditor and public information about enforcement actions and inspection reports. Some commenters suggested that the lead auditor should be allowed to rely on its network's quality control system when the other auditor and the lead auditor are in a common network.

The Board agrees that non-supervisory engagement team members may be involved in important audit areas requiring significant expertise and judgment. Thus, the Board is considering a new provision, requiring the lead auditor to inquire about the other auditor's policies and procedures²⁴ related to the training of all personnel who work on audits performed under PCAOB standards and the assignment of personnel to PCAOB audits.²⁵

By understanding the other auditor's policies and procedures for training and assigning its personnel, the lead auditor would be in a better position to identify matters that may warrant further attention. For example, if non-supervisory team members are not required to be trained on PCAOB standards, the lead auditor may decide to obtain additional information about the knowledge, skills, and ability of personnel performing important audit tasks in determining the necessary extent of supervision of their work. This new requirement seeks to promote the supplying of important information to the lead auditor without imposing unduly detailed requirements for all engagement team members from the other auditor.

²⁴ The proposed definition of "other auditor" includes both a firm and individuals from that firm. As a practical matter, this requirement would typically be applied at the firm level because the other auditor firm would have the relevant policies and procedures. The requirement would be applied at the individual level for participating persons who are not part of a firm.

²⁵ See proposed AS 2101.B6a in Appendix 1 and Appendix 2 of this release.

The Board does not currently intend to prescribe how the lead auditor should gain an understanding of the other auditors' knowledge, skill, and ability. The nature and extent of the lead auditor's procedures would depend to a large extent on the types of information available to the lead auditor about the other auditors. The Board expects, however, that gaining an understanding of the other auditors' knowledge, skill, and ability would necessarily involve obtaining information about the individuals who assist the lead auditor in planning or supervising the audit. For example, merely obtaining a statement from an affiliated firm (other auditor) that the firm complies with network-wide qualification requirements for personnel assigned to PCAOB audits would not provide sufficient information if the statement lacks specific information about the supervisory personnel on the engagement. Additional details about the knowledge, skill, and ability of those personnel would be needed to determine whether those individuals are qualified to perform the tasks assigned by the lead auditor. Possible sources of information that are relevant to the lead auditor's understanding of the knowledge, skill, and ability of relevant personnel include the lead auditor's own experience working with them, the other auditor's policies regarding the nature, scope, and timeliness of relevant training for them, information about internal inspection results regarding them, and publicly disclosed disciplinary action by regulators against them.²⁶

Question:

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

B. Supervision of Other Auditors

1. Risk-based Supervisory Approach

See proposed AS 1201 in Appendix 2

As discussed above, the 2016 Proposal would supersede AS 1205 and eliminate the ability of lead auditors to use the "work and reports" of other auditors under that standard. This would, in effect, require lead auditors to supervise other auditors under AS 1201 when the lead auditor assumes responsibility for the other auditors' work.²⁷ The proposal also would amend AS 1201 to provide additional direction to the lead

²⁶ See the 2016 Proposal at A4-26.

²⁷ Alternatively, proposed AS 1206 would apply when the firm issuing the audit report divides responsibility for an audit with another accounting firm and refers to the audit report of the other firm in the lead auditor's own audit report.

auditor on how to apply the principles-based provisions of AS 1201 to the supervision of other auditors.²⁸

In general, commenters supported the Board's consideration of a scalable, risk-based approach to the supervision of the other auditor's work that is grounded in existing PCAOB standards on supervision. For example, a number of commenters indicated that the level of the lead auditor's supervision should vary with the risks of material misstatement and the competency of the other auditors. Some of those commenters, however, questioned whether certain proposed requirements are designed to provide for variability in the level of supervision based on risk and the other auditors' competency.

The proposed requirements for the lead auditor's supervision of the work of other auditors are designed to be scalable based on risk and other factors. Under the 2016 Proposal, the engagement partner and others who assist the engagement partner in supervising the audit should determine the necessary extent of supervision, based on the risks of material misstatement to the company's financial statements and the knowledge, skill, and ability of the other auditor, among other things.²⁹ The application of this approach to certain specific proposed requirements is discussed in the sections below.

2. Instructing Other Auditors

See proposed paragraph .B2 of AS 1201 on p. A1-6 in Appendix 1

The 2016 Proposal would require the lead auditor to, among other things, communicate to the other auditor the scope of work to be performed and the tolerable misstatements and risks of material misstatement related to the work.

Commenters did not object to the general direction of the proposed amendments but suggested certain changes or clarifications. Some commenters suggested that the lead auditor's communication of risks of material misstatement be limited to risks that are relevant to the other auditor's work or to significant risks. Also, some commenters raised questions as to whether the lead auditor is the auditor best suited in all circumstances to assess risks of material misstatement at locations or business units audited by other auditors.

The Board does not currently intend to change the rule text for this proposed requirement because that requirement already provides that the lead auditor should communicate to the other auditors those risks of material misstatement that are relevant

²⁸ See Section IV of Appendix 4 of the 2016 Proposal.

²⁹ See AS 1201.06 and proposed AS 1201.B1 in Appendix 2 of this release.

to the other auditors' work.³⁰ Confining the communication requirement to significant risks would, in effect, ignore risks that still pose a reasonable possibility of material misstatement to the financial statements and, in turn, could lead to inadequate testing of significant accounts and disclosures. Any risks not identified by the lead auditor in its initial communication to the other auditor would be covered by an existing provision in AS 1201 to instruct the other auditors to bring any significant auditing issues, including any additional risks of material misstatement identified by the other auditor, to the attention of the engagement partner or other team members who perform supervisory activities.³¹ Furthermore, under the 2016 Proposal, the lead auditor would be required to 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.³²

3. Other Auditor Accountability and Duty to Provide a Written Report

See paragraph .02 of AS 1015 on p. A1-8 and proposed paragraph .B2 of AS 1201 on p. A1-6 in Appendix 1

The proposed amendments would not have retained the statement currently in AS 1205.03 (which would be superseded) that "the other auditor remains responsible for the performance of his own work and for his own report." The 2016 Proposal includes a new requirement in the standard on supervision according to which the lead auditor should obtain from the other auditor a written report describing the other auditor's procedures, findings, conclusions, and if applicable, opinion. The proposed requirement was intended to require the other auditor to make a written statement, and to inform the lead auditor, about the work for which the other auditor was responsible and the results of that work.

Some commenters expressed concern that the 2016 Proposal did not include the statement in AS 1205.03 about the other auditor's responsibility. Omitting this provision, in the commenters' view, may be interpreted as a reduction in the responsibility and accountability of the other auditors, with potential adverse effects on audit quality. Some commenters recommended retaining the existing provision or including an analogous requirement to address the other auditors' responsibility.

Additionally, regarding the proposed requirement for a "written report" from the other auditor to the lead auditor, some commenters asked for guidance on the content and form of such reports.

³⁰ See proposed AS 1201.B2a(2) in Appendix 2 of this release.

³¹ See AS 1201.05b in Appendix 2 of this release.

³² See proposed AS 2101.14 in Appendix 2 of this release.

In light of comments received, the Board is considering a revision that would amend AS 1015, *Due Professional Care in the Performance of Work*, to include a statement that other auditors are responsible for performing their work with due professional care.³³ This amendment would expressly remind other auditors of their current responsibility for their work under PCAOB rules and standards.³⁴

Regarding the comments about the written report, the Board wishes to point out that the other auditor's report is a non-public communication, to be tailored to meet the lead auditor's needs under its supervisory responsibilities, not a standardized report for general public use. Thus, the Board does not currently intend to prescribe the format of the other auditor's report. The required content of the report would remain the same as originally proposed – a description of the other auditor's procedures, findings, conclusions, and, if applicable, opinion, in sufficient detail for the necessary level of supervision.³⁵ To distinguish more clearly non-public communications between other auditors and the lead auditor (internal communication between two parties) from audit reports issued for general public use, the Board is considering a revision that would replace "written report" with "summary memorandum" in the proposed amendments to AS 1201.

As revised, this requirement to obtain a summary memorandum from the other auditor would be generally consistent with existing auditing practice. Observations from the Board's oversight activities indicate that many audit firms have developed firm-specific guidance for written communication to the lead auditor of the results of work performed on the audit by other firms. The form and content of those communications can vary, for example, depending on the nature of the work performed or whether the communication occurs between affiliated firms in the same network.

Question:

5. Are the proposed new addition to AS 1015 and revision to AS 1201 relating to the other auditors' responsibility appropriate and clear? Is it clear that AS 1015 already applies to referred-to auditors that perform audits under PCAOB standards?

³³ See proposed AS 1015.02 in Appendix 1 and Appendix 2 of this release.

³⁴ This amendment would not, of course, establish the sole responsibilities of other auditors. Like all auditors that participate in an audit performed under PCAOB standards, other auditors must comply with applicable PCAOB standards. See, e.g., PCAOB Rule 3100, *Compliance with Auditing and Related Professional Practice Standards*.

³⁵ Section III.B.4 of this release discusses the necessary level of review.

4. *Reviewing the Other Auditor's Work*

See proposed paragraph .B2 of AS 1201 on p. A1-6 in Appendix 1

Existing PCAOB standards establish requirements for the auditor's review of the work of the engagement team, and for the audit documentation that the office issuing the auditor's report is required to obtain, review, and retain.³⁶ The 2016 Proposal would provide additional direction to the lead auditor regarding the review of the other auditor's work. The 2016 proposed amendments would cover:

- Obtaining and reviewing the other auditor's description of the nature, timing, and extent of its audit procedures;³⁷
- Directing the other auditor to provide for review specified documentation of its work (which includes, but is not limited to, the documentation currently required by PCAOB standards);³⁸ and
- Obtaining from the other auditor a written report.³⁹ (As discussed above, the Board is considering revising the amendments to replace the term "written report" with "summary memorandum.")

Some commenters recommended clarifying whether the lead auditor would be allowed to adjust the extent of its review based on risk and the knowledge, skill, and ability of the other auditors' personnel who have already reviewed the work. Some commenters asked whether the lead auditor would be required to review all of the other auditors' audit documentation, including all of its planning documentation. In addition, some commenters suggested allowing the lead auditor to perform alternative procedures instead of reviewing documentation (e.g., holding discussions with other auditors, or reviewing documents remotely). Alternative approaches may be needed, in the commenters' view, if the other auditors' documentation is in a foreign language, or if the lead auditor's access to the documentation is restricted.

³⁶ See AS 1215.19. See also AS 1215.18, 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. Notably, proposed AS 2101.B6 requires the lead auditor to determine at the beginning of the engagement that the lead auditor is able to gain access to the other auditor's audit documentation. This access is important to enable the lead auditor to comply with the requirements of AS 1215 and to perform the required reviews in proposed AS 1201.B2.

³⁷ See proposed AS 1201.B2b in Appendix 1 of the 2016 Proposal.

³⁸ See proposed AS 1201.B2c in Appendix 1 of the 2016 Proposal.

³⁹ See proposed AS 1201.B2d in Appendix 1 of the 2016 Proposal.

Under the 2016 Proposal, the lead auditor would be required to determine the extent of audit documentation to be obtained and reviewed (e.g., other auditor's planning documentation, as well as the description of procedures performed, findings, conclusions, etc.) based on the factors set forth in the existing standard regarding the necessary extent of supervision.⁴⁰ For example, in addition to reviewing the documentation that existing and proposed standards require the lead auditor to review,⁴¹ the lead auditor may need to request from the other auditor and review certain audit documentation in areas involving higher risk or significant judgment.⁴² In another example, the lead auditor may need to examine more closely certain work performed and reviewed by the other auditor's personnel who have less expertise in a particular complex subject matter.⁴³ Similarly, the level of detail in the audit documentation to be obtained and reviewed by the lead auditor would depend on the factors in the existing standard regarding the necessary extent of supervision.⁴⁴

In light of comments received, the Board is considering revisions to proposed AS 1201.B2.⁴⁵ Specifically, two new notes would clarify that the necessary level of detail in the other auditor's documentation to be obtained and reviewed by the lead auditor should be determined by the lead auditor depending on the necessary extent of supervision of the other auditor's work.

The Board does not currently intend to change its standards to allow the lead auditor merely to hold discussions with the other auditor instead of reviewing the other auditor's documentation (although this does not preclude the lead auditor from using technology in order to review audit documentation). Proper review of audit documentation is an essential component of effective supervision.⁴⁶ However, as

⁴⁰ See AS 1201.06 in Appendix 2 of this release.

⁴¹ See (i) AS 1215.19, as proposed to be amended (in Appendix 2 of this release), and (ii) revised amendments relating to certain written communications from the other auditor in revised proposed AS 1201.B2d (in Appendix 1 and Appendix 2 of this release), which are described in Sections III.D and III.B.3 of this release.

⁴² See AS 1201.06c in Appendix 2 of this release.

⁴³ See AS 1201.06d in Appendix 2 of this release. See *also* proposed AS 2101.B6b in Appendix 2 of this release (requiring the lead auditor to gain an understanding of the knowledge, skill, and ability of the other auditors who assist the lead auditor with planning and supervision).

⁴⁴ This includes the level of detail of the summary memorandum discussed in Section III.B.3 of this release.

⁴⁵ See AS 1201.B2 in Appendix 1 and Appendix 2 of this release.

⁴⁶ See, e.g., AS 1201.05c in Appendix 2 of this release. If the other auditor's documentation was prepared in a foreign language, the lead auditor would need to

discussed in the prior paragraph, the necessary extent of the review is based on the factors in the existing standard regarding the necessary extent of supervision.

Question:

6. Are the proposed new additions to AS 2101.B2 appropriate and clear? Also, is it clear that the necessary level of detail of the other auditor's audit documentation that the lead auditor obtains and the necessary extent of the lead auditor's review according to requirements in proposed Appendix B of AS 1201 are scalable based on the factors in the existing standard regarding the necessary extent of supervision?

5. Multi-Tiered Audits

See proposed paragraph .B3 of AS 1201 on p. A1-7 in Appendix 1

In some audits that involve other auditors, the engagement team may be organized in a multi-tiered structure ("multi-tiered audit") in which an other auditor either audits 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, or assists the lead auditor in supervising the second other auditor. For example, in an audit of a U.S. multinational corporation that consolidates the results of its European operations in the U.K., the engagement team might consist of a U.S. firm as lead auditor, a U.K. auditor for the European operations, and a second other auditor who audits a business unit in Germany that is consolidated into the European operations audited by the U.K. firm. As another example, the lead auditor might ask an other auditor to assist in the supervision of a second other auditor.

For these arrangements, the 2016 Proposal would allow the lead auditor to direct the first other auditor to perform certain supervisory procedures on behalf of the lead auditor. The supervisory procedures that the lead auditor could assign to a first other auditor would have included reviewing the second other auditor's planned procedures and results of their work.⁴⁷

Commenters generally supported addressing multi-tiered audits in the proposed amendments. Some commenters, however, expressed concern about requiring the lead auditor, rather than the first other auditor, to communicate the scope of work, tolerable

adopt measures to facilitate a sufficient review by the lead auditor under the proposed requirements. For example, relevant audit documentation might be prepared or translated into the lead auditor's language to facilitate the review.

⁴⁷ See proposed AS 1201.B2b through .B2e in Appendix 1 of the 2016 Proposal, and revisions in Appendix 1 and Appendix 2 of this release.

misstatement, and risks of material misstatement to the second other auditor. Those commenters argued that the first other auditor often is better positioned to make those communications because the first other auditor may understand local operations and controls better than the lead auditor does.

In light of comments received, the Board has preliminarily concluded it would be appropriate to permit a first other auditor to make certain additional communications to a second other auditor in a multi-tiered audit, as long as the lead auditor receives adequate information about the communications. The Board therefore is considering revising the requirements for multi-tiered audits to allow the first other auditor to make the required communications described above, but require the lead auditor nonetheless to obtain, review, and retain a copy of those communications, or equivalent documentation. This revision would allow the most appropriate auditor (lead auditor or first other auditor) to communicate with the second other auditor. It would also enable the lead auditor (who is responsible for the scope of the entire audit) to assess whether the second other auditor is adequately informed, the scope of the second other auditor's work is appropriate, and the first other auditor is properly supervising the second other auditor's work.

Additionally, one commenter argued that certain documentation requirements in PCAOB standards do not take into account an engagement team that has a multi-tiered structure. The commenter discussed paragraph 19 of AS 1215, which requires the office issuing the auditor's report to obtain, and review and retain, prior to the report release date, certain documentation related to the work performed by other auditors, including the engagement completion document and summaries of identified misstatements and control deficiencies. The commenter suggested that it should not be necessary for a lead auditor to obtain and retain in the audit documentation the items noted in AS 1215.19 in relation to a second other auditor if the first other auditor had obtained and reviewed the work that had been performed by the second other auditor.

Consistent with an objective of AS 1215 that the issuing office have access to those working papers on which it placed reliance⁴⁸, the Board wishes to emphasize that the lead auditor would remain responsible for obtaining, reviewing, and retaining the documentation required by AS 1215.19, including in multi-tiered audits. In addition, a revision to the proposed amendments would require the lead auditor to obtain, review, and retain a copy of the summary memorandum provided by the second other auditor to the first other auditor. (See Section III.B.3 of this release for discussion of the summary memorandum.)

⁴⁸ See *Audit Documentation and Amendment to Interim Auditing Standards*, PCAOB Release No. 2004-006 (June 9, 2004), paragraph A63, at A1-28.

Question:

7. Are the revised proposed requirements for situations in which the lead auditor directs an other auditor to perform supervisory procedures with respect to a second other auditor on behalf of the lead auditor clear? If not, how should the revised proposed requirements be revised?

C. Proposed New Standard on Divided Responsibility

The 2016 Proposal includes a proposed new standard, AS 1206, that would apply to situations in which the lead auditor divides responsibility for the audit, and makes reference in the audit report to the audit and report of another firm, the referred-to auditor. The proposed standard would retain, with modifications, certain provisions currently in AS 1205 and would add certain other requirements, such as requiring the lead auditor to obtain a written representation from the referred-to auditor that it is licensed to practice in the relevant jurisdiction.⁴⁹

Commenters generally supported the proposed standard, and some commenters suggested certain revisions. Significant comments received and revisions that the Board is considering are discussed below.

1. Allowing the Division of Responsibility

See proposed AS 1206 in Appendix 3

Most commenters agreed with retaining the divided responsibility approach, which has long been permitted, because they observed no compelling practice issues that would suggest a need for change from this approach. Some commenters, however, expressed concern about the Board retaining the divided responsibility alternative. Those commenters argued that the lead auditor is ultimately responsible for the overall audit opinion and should not refer to other auditors.⁵⁰

After considering the comments, the Board has preliminarily decided to retain the divided responsibility alternative (with certain conditions) to address those situations in which, under the circumstances, it is impracticable for the lead auditor to supervise the work of another audit firm. Without the ability for the auditors to divide responsibility,

⁴⁹ See proposed AS 1206.05b in Appendix 3 of this release.

⁵⁰ Similar comments were made by certain SAG members 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") of the American Institute of Certified Public Accountants ("AICPA") acknowledged that AICPA standards allow for divided responsibility. (See transcript excerpts in [Docket 042](#), available on the PCAOB's website.)

some companies may encounter situations in which no audit 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 audit firm (or audit the entire consolidated financial statements), the lead auditor might withdraw from the engagement or disclaim its opinion because the lead auditor is unable to obtain sufficient appropriate evidence. As discussed above, divided responsibility engagements are relatively uncommon.⁵¹

2. Dealing with Different Financial Reporting Frameworks

See paragraph .06 of proposed AS 1206 on p. A1-12 in Appendix 1

One of the criteria in the proposed new standard for dividing responsibility for the audit is that the company and its business unit have prepared their financial statements using the same financial reporting frameworks (e.g., U.S. GAAP). Commenters expressed concern that this criterion would preclude auditors from dividing responsibility when it would otherwise be appropriate. Those commenters argued that the use of different financial reporting frameworks by business units exists, although relatively rare today,⁵² and may become more common with the increasing use of IFRS worldwide.

Other provisions of the standard could address the risks presented when responsibility for the audit is divided between a lead auditor and a firm that audits financial statements prepared using a different financial reporting framework. The Board therefore is considering adopting revisions to the proposed standard to allow division of the responsibility when the company and business unit prepare their financial statements under different financial reporting frameworks if (i) either the lead auditor or the referred-to other auditor audits the conversion adjustments and (ii) the lead auditor's report identifies who has audited the conversion adjustments.⁵³ These revisions would allow division of responsibility under this practical necessity, while informing investors about which auditor is responsible for auditing the conversion adjustments.

⁵¹ See note 13.

⁵² Based on PCAOB staff analysis of SEC filings as of August 3, 2017, Form 10-K and Form 20-F filings in fiscal year 2016 showed approximately five and three audits, respectively, in which the lead auditor divided responsibility with another auditor when the company and subsidiary prepared their financial statements under different financial reporting frameworks. In four of the filings, the lead auditor reported that it audited the conversion adjustments. In the other four filings, the auditor's reports did not indicate which auditor audited the conversion adjustments.

⁵³ Notably, the lead auditor would continue to be able to divide responsibility with another auditor when the financial statements of the company are prepared under the same financial reporting framework as those of the business unit audited by the referred to auditor, if the criteria a – c of proposed AS 1206.06 are met.

As revised, Appendix B to proposed AS 1206 also would contain examples of the introductory paragraphs in the lead auditor's report when the conversion adjustments are audited by (i) the lead auditor, and (ii) the referred-to auditor.

Question:

8. Is the revision to the proposed standard relating to the division of responsibility when the company and its business unit use different reporting frameworks appropriate and clear?

3. Referred-to Auditor's Qualifications

See paragraph .06b of proposed AS 1206 on p. A3-3 in Appendix 3

Another criterion in the proposed standard for dividing responsibility for the audit is that the lead auditor must determine, based on inquiries of the referred-to auditor and other information obtained during the audit, that the referred-to auditor has knowledge of relevant professional requirements and standards.

One commenter asked whether the lead auditor would be expected to evaluate the knowledge, skill, and ability of the referred-to auditor to the same extent as those of other auditors who are to be supervised. In the commenter's view, an example in the proposing release could go beyond the requirements of proposed AS 1206.⁵⁴

The Board believes that, in light of the comment, further explanation is appropriate. The purpose of understanding the qualifications of other auditors is different from that for referred-to auditors. For other auditors, the lead auditor would gain an understanding of the other auditors' knowledge, skill, and ability and use that understanding in determining the necessary extent of supervision of the other auditors.⁵⁵ For referred-to auditors, the lead auditor would make inquiries of the referred-to auditor and use other information obtained during the course of the audit to assess whether the referred-to auditor knows the relevant professional requirements and standards, which the lead auditor considers in deciding whether to divide responsibility for the audit.⁵⁶

⁵⁴ In the example, the referred-to auditor discussed his or her prior and current work experience with the lead auditor. See Section VII.B.4(iii) in Appendix 4 of the 2016 Proposal.

⁵⁵ See proposed AS 2101.B6b in Appendix 2 of this release.

⁵⁶ See proposed AS 1206.06b in Appendix 3 of this release.

4. Direction on the Decision to Make Reference to the Work and Report of Other Auditors

The proposal would supersede AS 1205 and would not retain certain direction (currently in AS 1205.05-.06) related to the lead auditor's decision to make reference (or not make reference) to the audit and report of another auditor.⁵⁷

Some commenters suggested that the Board retain some or all of the direction in AS 1205.05-.06. In particular, those commenters indicated that firms point to those paragraphs in deciding not to make reference to the audit and report of a network affiliate firm.⁵⁸

The Board does not currently intend to retain the direction suggested by the commenters. While network affiliation might be a practical consideration, the decision to divide responsibility should be determined based on the criteria set forth in the proposed standard and the lead auditor's ability to supervise the other auditor under PCAOB standards, as proposed to be amended.

5. Certain Required Interactions with the Referred-to Auditor

One commenter was concerned that the following proposed amendments would go beyond current practice for the division of responsibility:

- A proposed requirement for the lead auditor to 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

⁵⁷ AS 1205 uses the phrase "make reference" to describe situations in which the lead auditor divides responsibility with the other auditor and makes reference in the lead auditor's report to the audit and report of the other auditor. AS 1205.05-.06 describe situations in which the lead auditor ("principal auditor," as used in the terminology of AS 1205) may decide to make reference to the other auditor and those in which the lead auditor ordinarily would be in a position to issue the audit report without making reference to the other auditor (*i.e.*, the lead auditor would assume responsibility for the other auditor's work).

⁵⁸ Notably, the standard does not require auditors not to make reference in this situation. It merely states that ordinarily the lead auditor ("principal auditor," as used in the terminology of AS 1205) would be able to decide not to make reference if the other independent auditor "is an associated or correspondent firm...whose work is acceptable to the principal auditor based on his knowledge of the professional standards and competence of that firm."

consolidated financial statements associated with the location or business unit;⁵⁹ and

- A proposed amendment to update terminology in paragraph .53 of AS 2401, *Consideration of Fraud in a Financial Statement Audit*, by replacing "other independent auditor" with "other auditors or referred-to auditors," as follows:

.53 The following are examples of responses to assessed fraud risks involving the nature, timing, and extent of audit procedures:

* * *

- If other ~~independent auditors~~ or referred-to auditors are auditing the financial statements of one or more ~~subsidiaries, divisions, or branches~~, of the company's business units, discussing with them the extent of work that needs to be performed to address the fraud risk resulting from transactions and activities among these ~~components~~ business units. * * *

Having considered the comment, the Board is considering retaining the amendments as proposed. Those amendments are consistent with an existing requirement in AS 1205.10 that requires the lead auditor to, among other things, adopt appropriate measures to assure the coordination of its activities with those of the other auditor to achieve a proper review of matters affecting the consolidating or combining of accounts in the financial statements.⁶⁰ The requirement to discuss risks with the referred-to auditor is conditioned on, and limited to, the extent to which such discussion is necessary to identify and assess the risks to the consolidated financial statements associated with the location or business unit. And the conforming amendment to AS 2401 does not substantively change the example, but merely updates the terminology to align with the proposal.⁶¹

⁵⁹ See proposed AS 2101.14 in Appendix 2 of this release.

⁶⁰ Notably, AS 1205.10 applies to both scenarios: when the lead auditor assumes responsibility for the other auditor's work and when it divides responsibility for the audit with the other auditor.

⁶¹ Under existing PCAOB standards, the term "other auditors" encompasses both categories under AS 1205: those for which the lead auditor assumes responsibility and those with which the lead auditor divides responsibility. The 2016 Proposal uses the term "referred-to auditor" to distinguish it from auditors in the former category.

6. *Other Revisions*

See paragraphs .05 through .07 of proposed AS 1206 on p. A1-11 in Appendix 1

The Board is considering additional revisions to proposed AS 1206 with respect to the independence and licensing of the referred-to auditor. The 2016 Proposal would require the lead auditor to request a written representation from the referred-to auditor regarding the referred-to auditor's compliance with independence and ethics requirements of the PCAOB and independence requirements of the SEC, and regarding whether the referred-to auditor is licensed to practice under the laws of the applicable jurisdiction.⁶² A separate provision of proposed AS 1206 stated that the lead auditor would be permitted to divide responsibility for the audit only if the referred-to auditor's written representation, and the other information obtained by the lead auditor during the audit, indicate that the referred-to auditor is in compliance with the independence and ethics requirements of the PCAOB and independence requirements of the SEC and licensed to practice under the laws of the applicable jurisdiction.⁶³

Upon further analysis of these proposed provisions, the Board is considering revising proposed AS 1206.06 by removing the two limitations on the lead auditor's ability to divide responsibility for the audit discussed above. The Board has tentatively concluded that because independence and licensing of a referred-to auditor in AS 1206.06 are already addressed in AS 1206.05, removing the corresponding limitations from AS 1206.06 would reduce the complexity of the proposed standard without diminishing the lead auditor's responsibility to obtain and consider relevant information about the referred-to auditor's independence and licensing.⁶⁴ The other limitations in proposed AS 1206.06 on a lead auditor's ability to divide responsibility for the audit would remain, including the responsibility to obtain a representation that the referred-to auditor has performed an audit and issued an auditor's report in accordance with the standards of the PCAOB.

Additionally, the Board is considering revising the language in proposed AS 1206.05a, concerning representations about independence, to more closely conform to existing AS 1205.10.b. As revised, AS 1206.05a would provide that the lead auditor should obtain a written representation from the referred-to auditor that it is independent under the requirements of the PCAOB and of the SEC.⁶⁵ This revision would clarify that the Board intends to carry forward the approach in AS 1205.10b.

⁶² See proposed AS 1206.05 in Appendix 2 of the 2016 Proposal.

⁶³ See proposed AS 1206.06d in Appendix 2 of the 2016 Proposal.

⁶⁴ See, e.g., AS 2101.06b in Appendix 2 of this release.

⁶⁵ Under the 2016 Proposal, AS 1206.05a would require the lead auditor to request a written representation that the referred-to auditor is in compliance with the

Finally, the Board is considering replacing the examples in proposed AS 1206.07 of situations in which the auditor is unable to divide responsibility with broader examples, specifically, concerns about the other auditor's qualifications and concerns about whether the referred-to auditor's audit was in accordance with PCAOB standards. The first new example encompasses both competence and, when applicable, registration status. The second example covers situations in which information comes to lead auditor's attention that raises doubt about the referred-to auditor's representation that the audit was in accordance with PCAOB standards.⁶⁶

D. Documentation Amendments

1. Other Auditor's Working Papers Reviewed but Not Retained by Lead Auditor

See AS 1215 on p. A1-9 in Appendix 1

The 2016 Proposal would amend AS 1215 to require the lead auditor to prepare a list that (i) describes the other auditor's documentation which the lead auditor reviewed but did not retain and (ii) states the reviewer and date of review. This new requirement was intended to provide information about the lead auditor's review that currently may not be included in the other auditor's files or may not be accessible outside the country of the other auditor (when an audit involves foreign other auditors).

Some commenters supported the proposed requirement. Other commenters expressed concerns that the proposed requirement would not improve audit quality, but instead would be time-consuming at the end of the audit, and duplicate certain information about the other auditor's documentation.

After evaluating the commenters' arguments in light of other amendments the Board is considering adopting, the Board believes that existing requirements and other proposed requirements may adequately address the need to document the key materials reviewed by the lead auditor. Notably, as discussed above, the Board is considering a revised requirement that the lead auditor obtain, review, and retain a summary memorandum from the other auditor describing the other auditor's procedures, findings, conclusions, and, if applicable, opinion.⁶⁷ Even in a multi-tiered audit when the other auditor is supervised by another auditor, the lead auditor would be

independence and ethics requirements of the PCAOB and independence requirements of the SEC.

⁶⁶ This does not require the lead auditor search for contrary evidence or to perform any other procedures to assess the referred-to auditor's work, absent contrary information that raises doubt about the referred-to auditor's audit.

⁶⁷ See proposed AS 1201.B2d in Appendix 1 and Appendix 2 of this release.

required to obtain, review, and retain a copy of this summary memorandum.⁶⁸ The Board is therefore considering a revision that would remove the proposed requirement in AS 1215 that the lead auditor prepare a list of the other auditor's documentation reviewed but not retained by the lead auditor. The lead auditor would remain responsible for obtaining, reviewing, and retaining the information described in AS 1215.19,⁶⁹ and would have additional requirements for obtaining and reviewing documentation as discussed in Section III.B.4 of this release.

2. Amendments to AS 1215 Considered but Not Proposed

The 2016 Proposal invites comment on some potential amendments that are not included in the proposal. Specifically, the proposal asks (i) whether the lead auditor's files should list all of the other auditor's documentation, including that not reviewed by the lead auditor; and (ii) whether the office issuing the auditor's report should obtain from the other auditor, review, and retain certain information about related parties, significant unusual transactions, and all control deficiencies.

A number of commenters opposed requiring the lead auditor to list all of the other auditor's documentation. Some commenters added that such a requirement would be impractical and time consuming. Others noted that the cost of compiling a list of (potentially hundreds or thousands of) documents under a tight deadline at the end of the audit would exceed any marginal benefit.

Also, some commenters supported requiring the lead auditor to obtain, review, and retain certain additional information about related parties, significant unusual transactions, and control deficiencies, but other commenters opposed making such communication mandatory. Commenters who opposed the additional documentation generally indicated that, if not further clarified, the potential requirement may result in communicating to the lead auditor information that is inconsequential. One commenter added that the Board should assess the implementation of the auditing standard on related parties before requiring additional documentation in this area.

The Board, having considered the comments submitted, does not currently intend to propose additional requirements in these areas. Requiring the lead auditor to compile a complete list of other auditor's documentation could impose a substantial burden, as the Board acknowledged in the 2016 Proposal, without necessarily

⁶⁸ See proposed AS 1201.B3 in Appendix 1 and Appendix 2 of this release.

⁶⁹ Additional existing requirements are set forth in AS 1215.18. Also, Section 106(b) of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley") imposes certain requirements concerning production of the work papers of a foreign public accounting firm on whose opinion or services the auditor relies.

improving audit quality.⁷⁰ With regard to additional information about transactions with related parties and significant unusual transactions, the Board notes that its new standard and related amendments in this area recently went into effect, and the Board will continue to monitor the implementation of requirements of its auditing standards to assess the need for further revisions.⁷¹

E. Engagement Quality Review

AS 1220 requires the engagement quality reviewer to evaluate, among other things, significant judgments made by the engagement team. The 2016 Proposal would amend AS 1220 to require the engagement quality reviewer to evaluate the determination (discussed in Section III.A.1 of this release) that the participation of the engagement partner's firm in the audit is sufficient for the firm to serve as lead auditor, as follows:

- .10 In an audit, the engagement quality reviewer should:
- a. Evaluate the significant judgments that relate to engagement planning, including—

* * *

- 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. * * *

Some commenters supported the proposed requirement. Other commenters opposed the proposed requirement, contending that the sufficiency determination is not always a significant judgment and thus does not always warrant evaluation by the engagement quality reviewer.

⁷⁰ See the 2016 Proposal, at A4-42 ("Requiring the lead auditor to compile a list of all the audit documentation of all the other auditors participating in the audit could be burdensome, especially on larger audit engagements.").

⁷¹ See *Auditing Standard No. 18—Related Parties, Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions and Other Amendments to PCAOB Auditing Standards*, PCAOB Release No. 2014-002 (June 10, 2014). The new auditing standard and amendments became effective for audits of financial statements for fiscal years beginning on or after December 15, 2014.

The Board is considering retaining the requirement as originally proposed. Although determining the sufficiency of a firm's participation in the audit might not always be difficult or complicated, the decision that the firm can serve as lead auditor is a significant judgment because it affects whether the firm can issue the audit report. Thus, evaluating the sufficiency determination is important for the engagement quality reviewer's conclusion about whether the lead auditor's engagement report is appropriate in the circumstances of a particular audit.⁷²

F. Definitions

1. Proposed Definition of "Lead Auditor"

See definition of "lead auditor" in proposed paragraph .A4 of AS 2101 on p. A2-10, proposed paragraph .A4 of AS 1201 on p. A2-19 in Appendix 2, and paragraph .A2 of proposed AS 1206 on p. A3-6 in Appendix 3.

The 2016 Proposal introduces the term "lead auditor" which would apply to both of these scenarios: supervising other auditors under AS 1201 and dividing responsibility for the audit under proposed AS 1206. Under the proposal, the term "lead auditor" would apply to the firm issuing the auditor's report or supervisory personnel from that firm, depending on the context.

Some commenters suggested that the lead auditor definition be expanded to include qualified individuals outside the firm who assist with planning and supervising the audit. The suggested expansion would result in individuals outside the audit firm performing certain supervisory procedures that, under the 2016 Proposal, are reserved for personnel in the firm issuing the audit report.

In response to questions in the 2016 Proposal, a few commenters advocated that individuals performing procedures on an audit who are employees of:

- (i) network affiliate firms on secondment arrangements to the lead auditor, or
- (ii) shared service centers affiliated with the lead auditor

should be treated as personnel of the lead auditor, not other auditors. These commenters reasoned that these individuals function in the capacity of employees or an equivalent capacity as employees of the lead auditor firm.

The Board is considering retaining the definition of lead auditor as originally proposed. The commenters' concerns about the lead auditor's ability to assign certain planning and supervisory procedures to qualified individuals outside the firm are already

⁷² See AS 1220.12.

addressed in this release by the clarification of the proposed extent of the lead auditor's involvement in the supervision of other auditors (discussed in Sections III.B.2 and III.B.4 of this release), and potential revisions to the supervisory procedures for multi-tiered audits (discussed in Section III.B.5 of this release).

The Board agrees that, under the auditing standards amended by its proposal, secondees⁷³ from other accounting firms and employees of shared service centers⁷⁴ working under the lead auditor's guidance and control (as with other individuals who work in the role of firm employees⁷⁵) should be treated as employees of the lead auditor's firm. Importantly, the responsibilities for considering the independence and knowledge, skill, and ability of and for supervising these employees would be the same as for other employees of the lead auditor's firm who worked on the audit.

2. Alignment of Proposed Definitions with Non-PCAOB Rules

In addition to defining the term "lead auditor" (see above), the 2016 Proposal defines the terms "other auditor," "referred-to auditor," and "engagement team." Some commenters noted that the proposed terms are different from the terms used in the International Auditing and Assurance Standards Board's ("IAASB") International Standard on Auditing ("ISA") 600⁷⁶ and the AICPA's ASB AU-C Section 600⁷⁷, and recommended aligning the terminology of the PCAOB, IAASB, and ASB standards. In

⁷³ In this release, 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 another accounting firm, 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).

⁷⁴ In this release, the term "shared service center" refers to an entity affiliated with one or more firms that provides certain audit-related services to the firm(s) (generally standardized audit functions, such as testing the mathematical accuracy of issuer-prepared schedules, or managing external confirmations).

⁷⁵ Other examples of individuals who work in the role of firm employees include leased personnel in firms with alternative practice structures and temporary contractors who work alongside other lead auditor personnel on the audit.

⁷⁶ ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, effective for audits of group financial statements for periods beginning on or after December 15, 2009.

⁷⁷ AU-C Section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, effective for audits of group financial statements for periods ending on or after December 15, 2012.

addition, some commenters asked whether the proposed term "referred-to auditor" is aligned with the term "principal accountant" used by the SEC.

The Board is considering retaining the definitions as originally proposed. The proposed definitions are designed for the requirements in the 2016 Proposal, which differ from those in ISA 600 and AU-C Section 600.⁷⁸ Further, the proposed definitions would not affect the applicability of SEC terms or rules to audits involving other auditors or referred-to auditors, including the definition of "principal accountant."

G. Other Matters

1. *Replacing a Reference to AS 1205.12*

The 2016 Proposal includes a conforming amendment to AS 2601, *Consideration of an Entity's Use of a Service Organization*. AS 2601.19 currently requires the auditor to "give consideration to the guidance in AS 1205.12." The proposed amendment to AS 2601.19 would replace the reference with a list of the procedures from AS 1205.12 that are now incorporated by reference, as follows:

.19 In considering whether the service auditor's report is sufficient to meet his or her objectives, the user auditor should ~~give consideration to the guidance in AS 1205.12.~~ consider performing one or more of the following procedures:

- Visiting the service auditor and discussing the audit procedures followed and results thereof.
- Reviewing the audit programs of the service auditor. In some cases, it may be appropriate to issue instructions to the service auditor as to the scope of the audit work.
- Reviewing additional audit documentation of the service auditor.

* * *

Some commenters asked whether the Board intended to change practice by placing the procedures discussed in AS 1205.12 directly in AS 2601. One commenter observed that auditors, for various reasons, rarely perform these procedures. Another commenter thought the proposed amendment may lead an auditor to presume that more is required than just "considering" performing the procedures.

The Board is considering retaining the requirement as originally proposed. The proposed amendment in the 2016 Proposal would not substantively change the existing

⁷⁸

See Section II in Appendix 4 of the 2016 Proposal.

requirement, but rather preserve a referenced list of the procedures that are in a standard that is proposed to be superseded, aligning the language of the requirement more closely with PCAOB Rule 3101.⁷⁹

2. Interim Reviews

The 2016 Proposal does not include amendments (other than conforming amendments) for engagements other than audits, but the Board requests comment on whether changes are needed for reviews of interim financial information that involve other auditors or referred-to auditors.⁸⁰

The few commenters who responded to this question generally indicated that interim reviews in such audits should be addressed by the 2016 Proposal, but did not suggest any specific changes to standards. One commenter noted that any additional requirements should be scalable because the scope of an interim review is substantially less than that of an audit.

The Board, having evaluated the views and comments provided, is considering retaining conforming amendments to AS 4105 as proposed.

3. Investee Financial Statements Audited by Another Auditor

In some audits, auditors other than the lead auditor perform audit procedures on the financial statements of the company's investees (for example, in certain investments accounted for under the equity method). Existing AS 1205.14 discusses whether the auditor is in the position of a lead auditor ("principal auditor," as used in the terminology of AS 1205) and whether it may refer to the work and report of an auditor who performs work and issues a report on the financial statements of a part of the company for which the company accounts under either the equity method or cost method of accounting.

Since the 2016 Proposal would supersede AS 1205, some commenters asked about the applicability of the proposed amendments and proposed standard to audits in which investee financial statements are audited by another accounting firm.

The 2016 proposing release discusses the applicability of AS 1201 and the proposed standard to situations involving investments accounted for under the equity method that are selected for testing pursuant to AS 2101. The proposal explains that it is intended neither to expand nor narrow the range of situations currently covered by

⁷⁹ The auditor's responsibility to consider and the term "consider" are discussed in section (a)(3), *Responsibility to Consider*, of PCAOB Rule 3101, *Certain Terms Used in Auditing and Related Professional Practice Standards*.

⁸⁰ See proposed conforming amendments to AS 4105, *Reviews of Interim Financial Information*, in Appendix 3 of the 2016 Proposal.

AS 1201 and AS 1205.⁸¹ The Board currently intends to retain the approach described in the 2016 Proposal. Specifically, AS 1201, as proposed (and as the Board is considering revising as discussed in this release), would apply when the investor's equity in the underlying net assets and its share of the earnings or losses of the investee are recorded based on investee financial statements that are audited by an auditor other than the lead auditor, unless the lead auditor divides responsibility with the auditor of the investee, in which case the proposed standard AS 1206 would apply. This is consistent with the principle currently set forth in AS 1205.14.

With respect to other situations involving investee auditors, the auditor should follow direction in relevant PCAOB standards regarding obtaining sufficient appropriate audit evidence for investments whose valuation is based on the investee's financial condition or operating results.⁸²

4. Communication to the Audit Committee

See AS 1301 on p. A1-10 in Appendix 1

The 2016 proposing release asks whether the lead auditor's communication to the audit committee about the other auditors and referred-to auditors should be more specific than is currently required by paragraph .10d of AS 1301, *Communications with Audit Committees*.

Some commenters indicated that the existing requirements are appropriate and need not be changed. One other commenter suggested requiring the lead auditor to communicate to those charged with governance issues arising from the other auditors' non-compliance with PCAOB standards, in certain situations.

The Board is not proposing to add the suggested requirement. Under AS 1301, the auditor is already required to communicate to the audit committee matters arising

⁸¹ See AS 2101.11 through .14, in Appendix 2 of this release, which set forth requirements for determining locations or business units at which audit procedures should be performed.

⁸² See, e.g., paragraph .28 of AS 2503, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*. AS 2503 would be superseded under *Proposed Auditing Standard – Auditing Accounting Estimates, Including Fair Value Measurements and Proposed Amendments To PCAOB Auditing Standards*, PCAOB Release No. 2017-002 (June 1, 2017). PCAOB Release No. 2017-002 describes the auditor's responsibilities for obtaining sufficient appropriate audit evidence in certain situations in which the valuation of an investment is based on the investee's financial condition or operating results. (See proposed amendments to AS 1105, *Audit Evidence*, in PCAOB Release No. 2017-002.)

from the audit that are significant to the oversight of the company's financial reporting process.⁸³

Additionally, one commenter suggested modifying a proposed amendment to paragraph .10e of AS 1301 that would require the lead auditor to communicate to the audit committee certain matters relating to its sufficiency determination; the commenter recommended that this requirement apply only when significant parts of the audit are performed by other auditors.

The Board is considering revising the amendment so that the lead auditor is required to communicate to the audit committee the basis for determining the sufficiency of its participation only if significant parts of the audit are performed by other auditors or referred-to auditors.⁸⁴ This is intended to require communication about the sufficiency determination when it is most meaningful. As revised, the proposed amendment would essentially update terminology in existing AS 1301.10e by adding "referred-to auditors" to the phrase "if significant parts of the audit are to be performed by other auditors."

5. Further Conforming Amendments

If the Board adopts some or all of the amendments described in this release,⁸⁵ the Board would expect to include in the adopting release any necessary conforming amendments to auditing standards and rules of the Board that, at the time of adoption, are in effect or will be in effect. The 2016 Proposal included a number of conforming amendments to PCAOB auditing standards that were in effect at that time, but subsequently other amendments to Board standards were approved and became

⁸³ This may include general information about the use of other auditors (AS 1301.10d) and other matters such as difficulties encountered in performing the audit (AS 1301.23), which might include difficulties related to the use of other auditors.

⁸⁴ See proposed AS 1301.10e in Appendix 1 and Appendix 2 of this release.

⁸⁵ In addition to the amendments described in the release, Appendix 1 shows technical revisions to the following: note to proposed AS 2101.B1 (to make the first sentence parallel with second), second note to proposed AS 2101.B4 (to substitute "such" for "the"), and proposed AS 2101.B6c (to use terms "lead auditor" and "audit documentation"). These revisions would improve readability and use terminology consistent with existing PCAOB standards. They would not change the substance of auditor responsibilities.

effective.⁸⁶ In addition, the Board recently adopted⁸⁷ and proposed⁸⁸ amendments that may become effective before adoption of the 2016 Proposal.

Question:

9. Is it clear how the proposed amendments and new standard (as revised by this release) relate to other amendments to auditing standards proposed or adopted by the Board since the 2016 Proposal?

IV. Economic Considerations Relating to Certain Matters

The 2016 Proposal includes an economic analysis that describes, among other things, the baseline for evaluating the economic impacts of the proposal, analyzes the

⁸⁶ 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) (new Form AP and amendments to auditing standards to improve transparency regarding the engagement partner and other accounting firms that took part in the audit). The Board expects that further conforming amendments would, among other things, update references and terminology in Form AP.

⁸⁷ See *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) (amendments to require the auditor to report new information about the audit and make the audit report more informative and relevant). See also SEC, *Public Company Accounting Oversight Board; Notice of Filing of Proposed Rules on the Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion, and Departures From Unqualified Opinions and Other Reporting Circumstances, and Related Amendments to Auditing Standards*, Exchange Act Release No. 81187 (July 21, 2017), 82 FR 35396 (July 28, 2017) (SEC notice requesting comment on whether it should approve the amendments adopted by the PCAOB). If PCAOB Release No. 2017-001 is approved by the SEC, the Board expects that further conforming amendments would update references and terminology in AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, and other standards, as applicable. In addition, the example report in proposed AS 1206 would be amended to conform with AS 3101.

⁸⁸ See PCAOB Release No. 2017-002 (proposed amendments to strengthen and enhance the requirements for auditing accounting estimates); *Proposed Amendments to Auditing Standards for Auditor's Use of the Work of Specialists*, PCAOB Release No. 2017-003 (June 1, 2017) (proposed amendments to increase audit attention in areas where a specialist is used and align requirements with PCAOB risk assessment standards).

need for the proposal, and discusses potential economic impacts of the proposed requirements (including the potential benefits, costs, and unintended consequences). The analysis also discusses alternatives considered.

Commenters on the 2016 Proposal generally agreed with the analysis and did not raise comments unique to the economic analysis. The Board is soliciting comments on economic matters relating to the revisions and clarifications of the 2016 Proposal that are included in this supplemental request for comment. The Board also is requesting relevant information and empirical data regarding the revised proposal.

This section discusses the economic aspects of significant comments received on the 2016 Proposal, which pertain to the scalability of proposed amendments and the proposal's impact on smaller firms.

A. Scalability of Proposed Amendments

The 2016 Proposal would require the lead auditor to adjust (or "scale") its supervision of other auditors according to the complexity and the risk of material misstatement associated with the other auditors' work. Scalability is a characteristic of policy that typically refers to circumstances where requirements are general enough (e.g., principles-based) to be adapted effectively and efficiently under different facts and circumstances. Risk-based requirements are usually scalable because the necessary level of audit effort varies depending on the level of complexity and risk. Thus, risk-based requirements are likely to be relatively efficient (or at least not inefficient), because the auditor's incentives and discretion are likely to result in costs being incurred primarily in circumstances involving a corresponding, and potentially larger, risk-mitigation benefit to investors.

As discussed in Sections III.A and III.B of this release, some commenters asked whether the lead auditor could adjust the extent of certain proposed planning and supervisory procedures based on the facts and circumstances of the audit. The commenters cautioned that the cost of implementing requirements which are not sufficiently scalable could be unjustifiably high for audit firms (and issuers, to the extent cost is passed on to them), without corresponding benefits to audit quality.

In light of commenters' concerns, the Board wishes to reiterate that the requirements for the lead auditor in the 2016 Proposal are designed to be scalable based on several factors, including complexity and risk. Under the 2016 Proposal, the lead auditor would be required to determine the extent of supervision of other auditors based on, among other things, the nature of work, and risk of material misstatement.⁸⁹

⁸⁹ See proposed AS 1201.B1, in Appendix 2 of this release, which states: "In performing the procedures described in this appendix the lead auditor should determine

Section III of this release expressly addresses the scalability of specific proposed requirements, including proposed revisions thereto.⁹⁰ For example, a proposed revision would allow the lead auditor (where appropriate, based on risk and other factors) to seek assistance from the first-tier other auditors in communicating certain information to the lower tiers of other auditors.⁹¹ As another example, a proposed revision to .B2d of AS 1201 would require a summary memorandum from the other auditor, of which the form and content can vary.⁹²

B. Potential Impact on the Competitiveness of Smaller Audit Firms

The 2016 Proposal indicates it would likely have the greatest economic impact on audits performed by smaller firms when they use other auditors. This is because smaller firms, compared with larger firms, (i) are less likely to perform the proposed procedures today; and (ii) generally lack the economies of scale to distribute the additional fixed costs over many audits. The proposing release also notes that the 2016 Proposal could decrease competition in the audit market for audits involving other auditors if smaller firms are less able to compete with larger firms.⁹³

Some commenters were concerned that the proposal may put smaller audit firms at a competitive disadvantage compared to larger firms. One commenter indicated that, for smaller firms, complying with the proposed supervisory responsibilities may increase costs to such an extent that some smaller firms may exit the market for audits involving other auditors. Another commenter said that it would be harder for smaller firms than for larger firms to meet the proposed threshold for serving as lead auditor.

As noted in the previous sub-section, the proposed requirements are designed to be scalable and therefore applicable to audits of all sizes. Both the 2016 proposing release and this release discuss how the auditor could appropriately adjust the extent of its procedures to the circumstances of a particular audit. The Board believes that certain revisions to the 2016 Proposal that the Board is considering (and that are described in

the extent of supervision of the other auditors' work in accordance with paragraph .06 of [AS 1201]." The factors described in AS 1201.06 include, among other things, the nature of the work and risks of material misstatement.

⁹⁰ See, e.g., Section III.A.2, *Other Auditors' Compliance with Independence and Ethics Requirements*, Section III.A.3, *Other Auditors' Knowledge, Skill, and Ability*, Section III.B.2, *Instructing Other Auditors*, Section III.B.3, *Other Auditor Accountability and Duty to Provide a Written Report*, Section III.B.4, *Reviewing the Other Auditor's Work*, and Section III.B.5, *Multi-Tiered Audits*.

⁹¹ See detailed discussion in Section III.B.5 of this release.

⁹² See detailed discussion in Section III.B.3 of this release.

⁹³ See the 2016 Proposal, at 43.

this release) would further enhance the scalability of proposed supervision requirements. Further, adding a new sufficiency criterion for serving as lead auditor could address situations (which could be encountered by smaller firms) in which a location audited by the lead auditor does not comprise the greatest portion of the company's operations, but may still be important to the company.

As noted in the proposing release, the Board generally understands that smaller firms typically perform audits involving other auditors less often than larger firms do. If some smaller firms decide to discontinue performing audits involving other auditors, the Board expects that most, if not all, of those firms are likely to continue to conduct audits in other segments of the market, including private company audits, and issuer audits that do not involve other auditors.

C. Economic Impacts

As noted in the 2016 Proposal, the Board is mindful of the economic impacts of its standard setting. The 2016 Proposal included an economic analysis that discussed the benefits, costs, and potential unintended consequences of the proposed amendments.⁹⁴ The rule text revisions discussed in this release would make clarifying changes to address confusion expressed by commenters about certain aspects of the proposed rule text, or would make modest revisions to further carry out the policy approach of the 2016 Proposal. The Board has preliminarily concluded that the impact of the revisions discussed in this release relative to the 2016 Proposal would be negligible from an economic perspective – in other words, they would not significantly change the analysis set forth in the 2016 Proposal. The Board requests input from commenters about the potential economic impacts of these revisions.

Question:

10. Comment is requested on the matters discussed in this section. Would any revisions the Board is considering for adoption affect the scalability of PCAOB standards in this area? Would any have a significant effect on the competitiveness of smaller audit firms? Would the revisions significantly change the costs and benefits associated with the proposed changes discussed in the 2016 Proposal? Are there any unintended consequences that the Board should consider? Are there any other matters not addressed in this release the Board should consider in its economic analysis?

⁹⁴

See Section IV of the 2016 Proposal.

V. Considerations for Audits of Emerging Growth Companies

The 2016 proposed amendments and proposed standard would apply to audits of issuers, as defined in Section 2(a)(7) of Sarbanes-Oxley. The 2016 proposing release discusses and seeks comment on whether the proposed amendments and proposed standard should apply to audits of emerging growth companies ("EGCs"), as defined in Section 3(a)(80) of the Securities Exchange Act of 1934 ("Exchange Act").⁹⁵

No commenters opposed and several commenters expressly supported applying the proposed amendments and proposed standard to audits of EGCs. The Board continues to consider these comments. The Board also is seeking further comment, including any available empirical data, on how the revisions discussed in this release would affect EGCs and on whether the revised proposal would protect investors and promote efficiency, competition, and capital formation.⁹⁶

VI. Application to Audits of Brokers and Dealers

The 2016 proposed amendments would apply to audits of brokers and dealers, as defined in Sections 110(3)-(4) of Sarbanes-Oxley. In the 2016 proposing release the PCAOB discusses and solicits comment on the applicability of the proposed amendments and proposed standard to audits of brokers and dealers.⁹⁷

No commenters opposed and several commenters expressly supported applying the proposed amendments and proposed standard to audits of brokers and dealers. The Board continues to consider these comments. The Board also is seeking further comment on whether the revisions discussed in this release present specific issues with respect to audits of brokers and dealers.

⁹⁵ See Section V of the 2016 Proposal. See also Section 103(a)(3)(C) of Sarbanes-Oxley, as added by Section 104 of the Jumpstart Our Business Startups ("JOBS") Act. Section 104 of the JOBS Act also provides that any rules of the Board requiring (1) mandatory audit firm rotation or (2) a supplement to the auditor's report in which the auditor would be required to provide additional information about the audit and the financial statements of the issuer (auditor discussion and analysis) shall not apply to an audit of an EGC. The Board believes the 2016 proposed amendments and proposed standard do not fall within either of these two categories.

⁹⁶ See also PCAOB, *White Paper on Characteristics of Emerging Growth Companies as of November 15, 2016* (Mar. 28, 2017), available on the PCAOB's website.

⁹⁷ See Section VI of the 2016 Proposal.

VII. Effective Date

The Board seeks comment on the amount of time auditors would need before the proposed new auditing standard and amendments become effective, if adopted by the Board and approved by the SEC. Specifically, the Board is considering whether compliance with an adopted standard and amendments should be required for audits of fiscal years beginning in the year 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. The Board also is reopening the comment period for the 2016 Proposal, for any additional comments on other aspects of the 2016 Proposal. To assist the Board in evaluating such matters, the Board is requesting relevant information and empirical data regarding the revised proposed amendments and standard.

Written comments should be sent to the Office of the Secretary, PCAOB, 1666 K Street, NW, Washington, DC 20006-2803. Comments also may be submitted by e-mail to comments@pcaobus.org or through the Board's website at pcaobus.org. All comments should refer to PCAOB Rulemaking Docket Matter No. 042 in the subject or reference line and should be received by the Board no later than November 15, 2017.

The Board will consider all comments received. After the close of the comment period, the Board will determine whether to adopt final rules, with or without changes from those described in this release and in the 2016 Proposal. Any 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. Standards are rules of the Board under Sarbanes-Oxley.

* * *

On the 26th day of September, in the year 2017, 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 26, 2017

APPENDIX 1

Revisions to the 2016 Proposed Amendments Relating to the Performance of Audits Involving Other Auditors and Proposed Standard for Audits Involving Referred-to Auditors

This appendix presents revisions to amendments included in the 2016 Proposal for the following PCAOB standards:

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

In addition, the appendix presents revisions to AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*, as originally proposed. (This appendix does not present provisions of PCAOB standards that were included in the 2016 Proposal but that would not be revised by this supplemental request for comment.)

AS 2101, *Audit Planning*

* * *

Appendix B – Additional Requirements for the Lead Auditor When Planning an Audit that Involves Other Auditors or Referred-to Auditors

.B1 For engagements that involve other auditors or referred-to auditors, this appendix describes 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. ~~The lead auditor must supervise, in accordance with AS 1201,²⁵ 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.²⁶²⁵

²⁵ ~~AS 1201 establishes requirements regarding supervision of the audit engagement, including supervising the work of engagement team members.~~

²⁶²⁵ AS 1206 establishes requirements for the 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 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.

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

.B2 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:

- a. ~~¶~~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 (which includes considering the portion's

materiality), in comparison with the portions for which the other auditors perform audit procedures or the portions audited by the referred-to auditors; and

- b. The importance of the locations or business units 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 quantitative and qualitative factors.

In addition, the participation of the engagement partner's firm to serve as lead auditor ordinarily is not sufficient if the referred-to auditors, in aggregate, audit more than 50 percent of the company's assets or revenues.

.B3 In an integrated audit of financial statements and internal control over financial reporting, 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.

Other Auditors' Compliance with Independence and Ethics

.B4 In an audit that involves other auditors,²⁷²⁶ the lead auditor should determine each other auditor's compliance with the SEC independence requirements and PCAOB independence and ethics requirements by:

- a. Gaining an understanding of each other auditor's ~~knowledge of~~ (1) process for determining compliance with the SEC independence requirements and PCAOB independence and ethics requirements and their (2) experience in applying the requirements; and
- b. Obtaining a ~~written representation~~ from each other auditor:
- (1) 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; and
- (2) A written representation that it is, or is not, in compliance with SEC independence requirements and PCAOB independence and ethics requirements and, if it is not, a description of the nature of any non-compliance.

Note: 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.

Note: If the lead auditor becomes aware of information during the course of the audit that contradicts an other auditor's description of its relationships that may reasonably be thought to bear on independence or a representation made by an other auditor regarding its compliance with the SEC independence requirements and PCAOB independence and ethics requirements, the lead auditor should perform additional procedures to determine the effect of ~~the~~ such information on the independence of the other auditor.

²⁷²⁶ 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.

Registration Status of Other Auditors

.B5 In an audit that involves an other 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, the lead auditor may use an other auditor only if the other auditor is registered pursuant to the rules of the PCAOB.²⁸²⁷

²⁸²⁷ 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 referred-to auditor.

Qualifications of and Communication with Other Auditors

.B6 At the beginning of an audit that involves other auditors, the lead auditor should:

a. Inquire about other auditors' policies and procedures relating to the:

- (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;

- a-b. Gain an understanding of the knowledge, skill, and ability of the other auditors who assist the lead auditor with planning or supervision,²⁹²⁸ 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-c. Determine that ~~it~~ the lead auditor is able to communicate with the other auditors and gain access to their work papers ~~the other auditors' audit documentation~~.³⁰²⁹

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

²⁹²⁸ See AS 1015.06, according to which "[a]uditors should be assigned to tasks and supervised commensurate with their level of knowledge, skill, and ability", and AS 2301.05a, 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.

³⁰²⁹ See, e.g., AS 1201.05, and Appendix B of AS 1201, which establish requirements for the auditor's review of work performed by engagement team members. See also AS 1215.18, 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.

* * *

AS 1201, *Supervision of the Audit Engagement*

* * *

Appendix B – Procedures to Be Performed by the Lead Auditor with Respect to the Supervision of the Other Auditors' Work

.B1 For engagements that involve other auditors, this appendix describes procedures to be performed by the lead auditor with respect to the supervision of the other auditors' work, in conjunction with the required supervisory activities set forth in this standard. The requirements of this appendix supplement the requirements in paragraph .05 of this

standard. In performing the procedures described in this appendix the lead auditor should determine the extent of supervision of the other auditors' work in accordance with paragraph .06 of this standard.

Note: The lead auditor should hold discussions with and obtain information from the other auditors, as necessary for the performance of procedures described in this appendix.

.B2 In supervising the work of other auditors, the lead auditor should:¹⁸

a. Inform the other auditor of the following in writing:

- (1) The scope of work to be performed by the other auditor; and
- (2) Tolerable misstatement,¹⁹ the identified risks of material misstatement,²⁰ and, if determined, the amount below which misstatements are clearly trivial and do not need to be accumulated²¹ relevant to the work requested to be performed.

b. Obtain and review the other auditor's description ~~of the nature, timing, and extent of the~~ audit procedures to be performed pursuant to the scope of work described in paragraph .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 the necessary extent of supervision of the other auditor's work by the lead auditor, it may be necessary for the lead auditor (rather than the other auditor) to determine the nature, timing, and extent of procedures to be performed.

c. Direct the other auditor to provide for review specified documentation with respect to the work requested to be performed;²²

- d. Obtain from the other auditor a ~~written report~~ 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 supervision of the other auditor's work by the lead auditor.

- e. Determine, based on a review of the documentation and ~~written report~~ summary memorandum provided by the other auditor (pursuant to paragraphs .B2c and .B2d of this appendix), discussions with the other auditor, and other information obtained during the audit:
- (1) Whether the other auditor complied with the written communications received pursuant to paragraphs .B2a and .B2b; and
 - (2) Whether additional audit evidence should be obtained with respect to the work performed by the other auditor, for example, to address a previously unidentified risk of material misstatement or in a situation in which 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 locations regarding risks of material misstatement.

²¹ See AS 2810.10–.11.

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

²³ See AS 2810.35–.36.

.B3 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 the lead auditor in supervising a second other auditor.²⁴ In these situations, the lead auditor may direct the first other auditor to perform the procedures in ~~paragraphs .B2b through .B2c~~paragraph .B2 with respect to the second other auditor on behalf of the lead auditor, 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 ~~informing directly both the first other auditor and second other auditor of the matters in paragraph .B2a~~obtaining, reviewing, and retaining the documentation required by AS 1215.19.

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

* * *

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.

.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.

.03 *Cooley on Torts*, a legal treatise, describes the obligation for due care as follows:

Every man who offers his services to another and is employed assumes the duty to exercise in the employment such skill as he possesses with reasonable care and diligence. In all these employments where peculiar skill is

requisite, if one offers his services, he is understood as holding himself out to the public as possessing the degree of skill commonly possessed by others in the same employment, and if his pretensions are unfounded, he commits a species of fraud upon every man who employs him in reliance on his public profession. But no man, whether skilled or unskilled, undertakes that the task he assumes shall be performed successfully, and without fault or error; he undertakes for good faith and integrity, but not for infallibility, and he is liable to his employer for negligence, bad faith, or dishonesty, but not for losses consequent upon pure errors of judgment.²

² D. Haggard, *Cooley on Torts*, 472 (4th ed., 1932).

.04 The matter of due professional care concerns what the independent auditor does and how well he or she does it. The quotation from *Cooley on Torts* provides a source from which an auditor's responsibility for conducting an audit with due professional care can be derived. The remainder of the section discusses the auditor's responsibility in the context of an audit.

.05 An auditor should possess "the degree of skill commonly possessed" by other auditors and should exercise it with "reasonable care and diligence" (that is, with due professional care).

.06 Auditors 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*.

* * *

AS 1215, *Audit Documentation*

* * *

Retention of and Subsequent Changes to Audit Documentation

* * *

~~.19A—Audit documentation of the office issuing the auditor's report must contain a list of additional work papers of other auditors (beyond those described in paragraph .19) that~~

~~were reviewed by the lead auditor^{4A} but not retained by the lead auditor, if any. The list must include a description of the work papers reviewed, the reviewer, and the date of such review.~~

~~Note: According to paragraph .18, audit documentation supporting the work performed by other auditors must be retained by or be accessible to the office issuing the auditor's report.~~

~~^{4A} — The term "lead auditor," as used in this paragraph, has the same meaning as in Appendix A of AS 1201.~~

* * *

AS 1301, *Communications with Audit Committees*

* * *

Obtaining Information and Communicating the Audit Strategy

* * *

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:

- a. The nature and extent of specialized skill or knowledge needed to perform the planned audit procedures or evaluate the audit results related to significant risks;⁹
- b. The extent to which the auditor plans to use the work of the company's internal auditors in an audit of financial statements;¹⁰
- c. The extent to which the auditor plans to use the work of internal auditors, company personnel (in addition to internal auditors), and third parties working under the direction of management or the audit committee when performing an audit of internal control over financial reporting;¹¹
- d. The names, locations, and planned responsibilities¹² of other auditors that perform audit procedures in the current period audit or referred-to auditors that audit portions of the company's financial statements in the current period audit and, if applicable, internal control over financial reporting;^{12A} and

- e. In an audit that involves other auditors or referred-to auditors, the basis for the engagement partner's determination that the participation of his or her firm is sufficient to serve as the lead auditor, if significant parts of the audit are to be performed by other auditors or referred-to auditors.¹³

⁹ See AS 2101.16 for the requirement for the auditor to determine whether specialized skill or knowledge is needed to perform appropriate risk assessments, plan or perform audit procedures, or evaluate audit results.

¹⁰ See AS 2605, *Consideration of the Internal Audit Function*, which describes the auditor's responsibilities related to the work of internal auditors.

¹¹ See paragraphs .16–.19 of AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, which describe the auditor's responsibilities related to using the work of others in an audit of internal control over financial reporting.

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 in multi-location engagements.

^{12A} The terms "other auditor" and "referred-to auditor" in this standard have the same meaning as in Appendix A of AS 2101, *Audit Planning*.

¹³ See AS 2101.B2 and .B3, which establish requirements regarding serving as the lead auditor.

* * *

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

* * *

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

* * *

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

- a. Independent under the ~~In compliance with the independence and ethics requirements of the PCAOB and the U.S. Securities and Exchange Commission ("SEC"); and~~

- 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:

* * *

- d. ~~The representations from the referred-to auditor described in paragraph .05 and other information obtained by the lead auditor during the audit indicates that:~~
 - (1) ~~The referred to auditor is in compliance with the independence and ethics requirements of the PCAOB and the SEC; and~~
 - (2) ~~The referred to auditor is duly licensed to practice under the laws of the jurisdiction that apply to the work of the referred to auditor; and~~

* * *

- ~~b.d.~~ In situations when the financial statements of the company's business unit audited by the referred-to auditor were prepared using the same a financial reporting framework as 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) 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 competence or independence/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:

* * *

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:

* * *

Note: Appendix B includes ~~an 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.

* * *

APPENDIX 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

* * *

Alternative Paragraphs 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 1: Conversion Adjustments Audited by 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 opinions, insofar as they relate 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 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, respectively, and total revenues constituting XX percent, YY percent, and ZZ percent of consolidated revenues for the years ended December 31, 20X3, 20X2, and 20X1, 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: Conversion Adjustments Audited by 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], 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 opinions, insofar as they relate 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 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, respectively, and total revenues constituting XX percent, YY percent, and ZZ percent of consolidated revenues for the years ended December 31, 20X3, 20X2, and 20X1, respectively.

APPENDIX 2

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, revised by this supplemental request for comment) for the following PCAOB standards:

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

These provisions are presented as if existing PCAOB standards were amended by the 2016 Proposal and this supplemental request for comment. Language that would be deleted is ~~struck through~~. Language that would be added is underlined. (This appendix does not present provisions of PCAOB standards that were included in the 2016 Proposal but that would not be revised by this supplemental request for comment.)

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 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

.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.

.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 and ethics requirements, 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.

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 committee⁶ 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 activities⁹ 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 the Performance of Work*, and paragraph .06 of AS 1201, *Supervision of the Audit Engagement*. See also Appendix B of AS 1201, which describes further procedures to be performed by the lead auditor with respect to the supervision of the other auditors' work, in conjunction with the required supervisory activities set forth in AS 1201.

⁹ Paragraph .06 of this standard.

¹⁰ See, e.g., ~~paragraph .06 of AS 1015, *Due Professional Care in the Performance of Work*~~ AS 1015.06, paragraph .16 of this standard, and paragraph .05a. of AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*.

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.

.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 possibility¹⁶ 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 2201¹⁷ 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 Other Independent Auditors*, describes the auditor's responsibilities regarding using the work and reports of 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 an audit that involves other auditors or referred-to auditors these situations, 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 auditors¹⁸ 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 ~~For integrated audits, see also AS 2201.C8 .C11.AS 2110.49-.53 describe conducting a discussion among engagement team members regarding risks of material misstatement.~~

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 accountants²⁰ 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.²¹

²⁰ See paragraph (a)(ii) in PCAOB Rule 1001, *Definitions of Terms Employed in Rules*.

²¹ See AS 1210.

.A4 Lead auditor –

- a. The registered public accounting firm²² 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 1201.²³

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

²² 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, 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.

.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 units²⁴ 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.

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

Appendix B – Additional Requirements for the Lead Auditor When Planning an Audit that Involves Other Auditors or Referred-to Auditors

.B1 For engagements that involve other auditors or referred-to auditors, this appendix describes 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 and, if applicable, internal control over financial reporting with another accounting firm 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.

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

.B2 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:

- a. 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
- b. The importance of the locations or business units 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 quantitative and qualitative factors.

In addition, the participation of the engagement partner's firm to serve as lead auditor ordinarily is not sufficient if the referred-to auditors, in aggregate, audit more than 50 percent of the company's assets or revenues.

.B3 In an integrated audit of financial statements and internal control over financial reporting, 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.

Other Auditors' Compliance with Independence and Ethics

.B4 In an audit that involves other auditors,²⁶ the lead auditor should determine each other auditor's compliance with the SEC independence requirements and PCAOB independence and ethics requirements by:

- a. Gaining an understanding of each other auditor's (1) process for determining compliance with the SEC independence requirements and PCAOB independence and ethics requirements and (2) experience in applying the requirements; and
- b. Obtaining from each other auditor:
 - (1) 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; and
 - (2) A written representation that it is, or is not, in compliance with SEC independence requirements and PCAOB independence and ethics requirements and, if it is not, a description of the nature of any non-compliance.

Note: 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.

Note: If the lead auditor becomes aware of information during the course of the audit that contradicts an other auditor's description of its relationships that may reasonably be thought to bear on independence or a representation made by an other auditor regarding its compliance with the SEC independence requirements and PCAOB independence and ethics requirements, the lead auditor should perform additional procedures to determine the effect of such information on the independence of the other auditor.

²⁶ 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.

Registration Status of Other Auditors

.B5 In an audit that involves an other 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, the lead auditor may use an other auditor only if the other auditor is registered pursuant to the rules of the PCAOB.²⁷

²⁷ 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 referred-to auditor.

Qualifications of and Communication with Other Auditors

.B6 At the beginning of an audit that involves other auditors, the lead auditor should:

a. Inquire about other auditors' policies and procedures relating to the:

(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 an understanding of the knowledge, skill, and ability of the other auditors who assist the lead auditor with planning or supervision,²⁸ 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

c. Determine that the lead auditor is able to communicate with the other auditors and gain access to the other auditors' audit documentation.²⁹

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

²⁸ See AS 1015.06, according to which "[a]uditors should be assigned to tasks and supervised commensurate with their level of knowledge, skill, and ability", and AS 2301.05a, 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.

²⁹ See, e.g., AS 1201.05, and Appendix B of AS 1201, which establish requirements for the auditor's review of work performed by engagement team members. See also AS 1215.18, 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.

* * *

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

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**⁴ 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 ~~and~~ 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

Note: Appendix B describes further 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.

² AS 1210, *Using the Work of a Specialist*.

~~³ AS 1205, *Part of the Audit Performed by Other Independent Auditors*.~~

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*.

.04 The engagement partner may seek assistance from appropriate engagement team members 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*, 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.

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 accountants¹⁴ 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 firm¹⁶ 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.

Appendix B – Procedures to Be Performed by the Lead Auditor with Respect to the Supervision of the Other Auditors' Work

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

Note: The lead auditor should hold discussions with and obtain information from the other auditors, as necessary for the performance of procedures described in this appendix.

.B2 In supervising the work of other auditors, the lead auditor should:¹⁸

a. Inform the other auditor of the following in writing:

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

(2) Tolerable misstatement,¹⁹ the identified risks of material misstatement,²⁰ and, if determined, the amount below which misstatements are clearly trivial and do not need to be accumulated²¹ relevant to the work requested to be performed.

b. Obtain and review the other auditor's description of the audit procedures to be performed pursuant to the scope of work described in paragraph .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 the necessary extent of supervision of the other auditor's work by the lead auditor, it may be necessary for the lead auditor (rather than the other auditor) to determine the nature, timing, and extent of procedures to be performed.

c. Direct the other auditor to provide for review specified documentation with respect to the 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 supervision of the other auditor's work by the lead auditor.

- e. Determine, based on a review of the documentation and summary memorandum provided by the other auditor (pursuant to paragraphs .B2c and .B2d of this appendix), discussions with the other auditor, and other information obtained during the audit:
- (1) Whether the other auditor complied with the written communications received pursuant to paragraphs .B2a and .B2b; and
 - (2) Whether additional audit evidence should be obtained with respect to the work performed by the other auditor, for example, to address a previously unidentified risk of material misstatement or in a situation in which 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 locations regarding risks of material misstatement.

²¹ See AS 2810.10–.11.

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

²³ See AS 2810.35–.36.

.B3 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 the lead auditor in supervising a second other auditor.²⁴ In these situations, the lead auditor may direct the first other auditor to perform the procedures in paragraph .B2 with respect to the second other auditor on behalf of the lead auditor, 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.

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

* * *

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.

.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.

.03 *Cooley on Torts*, a legal treatise, describes the obligation for due care as follows:

Every man who offers his services to another and is employed assumes the duty to exercise in the employment such skill as he possesses with reasonable care and diligence. In all these employments where peculiar skill is requisite, if one offers his services, he is understood as holding himself out to the public as possessing the degree of skill commonly possessed by others in the same employment, and if his pretensions are unfounded, he commits a species of fraud upon every man who employs him in reliance on his public profession. But no man, whether skilled or unskilled, undertakes that the task he assumes shall be performed successfully, and without fault or error; he undertakes for good faith

and integrity, but not for infallibility, and he is liable to his employer for negligence, bad faith, or dishonesty, but not for losses consequent upon pure errors of judgment.²

² D. Haggard, *Cooley on Torts*, 472 (4th ed., 1932).

.04 The matter of due professional care concerns what the independent auditor does and how well he or she does it. The quotation from *Cooley on Torts* provides a source from which an auditor's responsibility for conducting an audit with due professional care can be derived. The remainder of the section discusses the auditor's responsibility in the context of an audit.

.05 An auditor should possess "the degree of skill commonly possessed" by other auditors and should exercise it with "reasonable care and diligence" (that is, with due professional care).

.06 Auditors 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*.

* * *

AS 1215, Audit Documentation

* * *

Retention of and Subsequent Changes to Audit Documentation

* * *

.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} ~~(including auditors associated with other offices of the firm, affiliated firms, or non-affiliated firms)~~, must be retained by or be accessible to the office issuing the auditor's report.⁴

^{3A} The term "other auditors," as used in this standard, has the same meaning as in Appendix A of AS 1201.

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~~on whose opinion or services the auditor relies~~. 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 offices of the firm and other auditors~~(including auditors associated with other offices of the firm, affiliated firms, or non-affiliated firms)~~:

- 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 other offices of the firm and the 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*.~~

* * *

AS 1301, *Communications with Audit Committees*

* * *

Obtaining Information and Communicating the Audit Strategy

* * *

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:

- a. The nature and extent of specialized skill or knowledge needed to perform the planned audit procedures or evaluate the audit results related to significant risks;⁹
- b. The extent to which the auditor plans to use the work of the company's internal auditors in an audit of financial statements;¹⁰
- c. The extent to which the auditor plans to use the work of internal auditors, company personnel (in addition to internal auditors), and third parties working under the direction of management or the audit committee when performing an audit of internal control over financial reporting;¹¹
- d. The names, locations, and planned responsibilities¹² of other independent public accounting firms or other persons, who are not employed by the auditors, that perform audit procedures in the current period audit or referred-to auditors that audit portions of the company's financial statements in the current period audit and, if applicable, internal control over financial reporting;^{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 basis for the auditor's determination that the auditor can serve as principal auditor~~In an audit that involves other auditors or referred-to auditors, the basis for the engagement partner's determination that the participation of his or her firm is sufficient to serve as the lead auditor, if significant parts of the audit are to be performed by other auditors or referred-to auditors.¹³

⁹ See AS 2101.16 for the requirement for the auditor to determine whether specialized skill or knowledge is needed to perform appropriate risk assessments, plan or perform audit procedures, or evaluate audit results.

¹⁰ See AS 2605, *Consideration of the Internal Audit Function*, which describes the auditor's responsibilities related to the work of internal auditors.

¹¹ See paragraphs .16–.19 of AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, which describe the auditor's responsibilities related to using the work of others in an audit of internal control over financial reporting.

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 multi-location engagements.

^{12A} The terms "other auditor" and "referred-to auditor" in this standard have the same meaning as in Appendix A of AS 2101, *Audit Planning*.

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~~AS 2101.B2 and .B3, which establish requirements regarding serving as the lead auditor.

APPENDIX 3

This appendix presents proposed AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*, modified for the revisions presented in this supplemental request for comment.

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 statements² and, if applicable, internal control over financial reporting with a **referred-to auditor**.³

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

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 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

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

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*.

⁴ See paragraphs .B2 and .B3 of AS 2101.

regarding the supervision of the work of the engagement team members, including those not employed by the lead auditor.⁵

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 (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 units⁶ audited by the referred-to auditor into the company's financial statements.⁷ 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
- b. Duly licensed to practice under the laws of the jurisdiction that apply to the work of the referred-to auditor.

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

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

⁷ See paragraphs .30 and .31 of AS 2810, *Evaluating Audit Results*.

.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 audit and issued an auditor's report in accordance with the standards of the PCAOB;⁸
- b. The lead auditor determines, based on inquiries made to the referred-to auditor and other information obtained by the lead auditor during the audit, that the referred-to auditor knows 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 the PCAOB;⁹ and
- d. In situations when the financial statements of the company's business unit audited by the referred-to auditor were 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) has taken responsibility for auditing the conversion adjustments.

⁸ 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 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 audits of management's assessment of the effectiveness of internal control over financial reporting that is integrated with an audit of the financial statements.

⁹ 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."

.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 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, 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

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

¹⁰ 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)."

- 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 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

.09 If the report of the referred-to auditor is other than a standard report, the lead auditor should make reference to the departure from the standard report and its disposition in the lead auditor's report, unless the matter is clearly trivial to the company's financial statements.

¹¹ 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 See, e.g., AS 2201.C10.

APPENDIX A – Definitions

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

.A2 Lead auditor –

- a. The registered public accounting firm¹³ 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 units¹⁵ 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.

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.

APPENDIX 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:

Report of Independent Registered Public Accounting Firm¹⁶

[Introductory paragraphs]

We have audited the accompanying consolidated balance sheets of X Company and subsidiaries as of December 31, 20X3 and 20X2, and the related consolidated statements of operations, stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 20X3. We also have audited X Company's 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)*"]. X Company's management is responsible for these 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 these financial statements and an opinion on the company's internal control over financial reporting based on our audits.

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, respectively, and total revenues constituting XX percent, YY percent, and ZZ percent of consolidated revenues for the years ended December 31, 20X3, 20X2, and 20X1, 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

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.

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

[Scope paragraph]

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. 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. We believe that our audits and the report of Firm ABC provide a reasonable basis for our opinions.

[Definition paragraph]

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.

¹⁷ 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.

[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)."].

[Signature]

[City and State or Country]

[Date]

Alternative Paragraphs 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 1: Conversion Adjustments Audited by 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 opinions, insofar as they relate 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 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, respectively, and total revenues constituting XX percent, YY percent, and ZZ percent of consolidated revenues for the years ended December 31, 20X3, 20X2, and 20X1, 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: Conversion Adjustments Audited by 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], 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 opinions, insofar as they relate 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 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, respectively, and total revenues constituting XX percent, YY percent, and ZZ percent of consolidated revenues for the years ended December 31, 20X3, 20X2, and 20X1, respectively.



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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.

Board Contacts: Barbara Vanich, PCAOB Acting Chief Auditor, Office of the Chief Auditor (202/207-9363, vanichb@pcaobus.org); Dima Andriyenko, Acting Deputy Chief Auditor (202/207-9130, andriyenkod@pcaobus.org); Lillian Ceynowa, Associate Chief Auditor (202/591-4236, ceynowal@pcaobus.org); Stephanie Hunter, Assistant Chief Auditor (202/591-4408, hunters@pcaobus.org); Andrew Cleve, Assistant Chief Auditor (646/437-5271, clevea@pcaobus.org); Hunter Jones,

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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 Proposal¹ 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

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*.

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

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

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 accountants¹⁷ 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

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 firm²¹ issuing the auditor’s report on the company’s financial statements and, if applicable, internal control over financial reporting; and

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

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 secondees²⁶ 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 individuals²⁷ 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.

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 units²⁹ and issues an auditor's report in accordance with the standards of the PCAOB to which the lead auditor makes reference in the lead

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 .06B³¹ 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-

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 considerations³³ should

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’

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 Procedures³⁶

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

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 obtain³⁹ 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 affirmation⁴² 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

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.

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 Relationships⁴⁷

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 client⁴⁸ 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

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 Requirements⁵²

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

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 Information⁵⁴

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

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 Status⁵⁶

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?

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 of⁵⁹ and Communications with Other Auditors

See paragraph .06H⁶⁰ 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 auditor⁶⁴ 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.

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

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 Obtaining⁷² 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.)

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

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

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 unit⁸¹ 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

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

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

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 affirmation⁹⁷ 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

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

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.)

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

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 amendments¹⁰³ 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 amendments¹⁰⁵ 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,

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.

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.

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 auditor¹¹⁴). 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

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

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 analysis¹²⁶). 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

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 adjustments¹²⁸ 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

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 auditor¹³¹ 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.

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?

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:

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

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.

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

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

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 deficiencies¹⁵³ in roughly 25 to 45 percent of referred work engagements¹⁵⁴ 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

¹⁵⁰ See 2016 Proposal at 16.

¹⁵¹ *Id.*

¹⁵² *Id.*

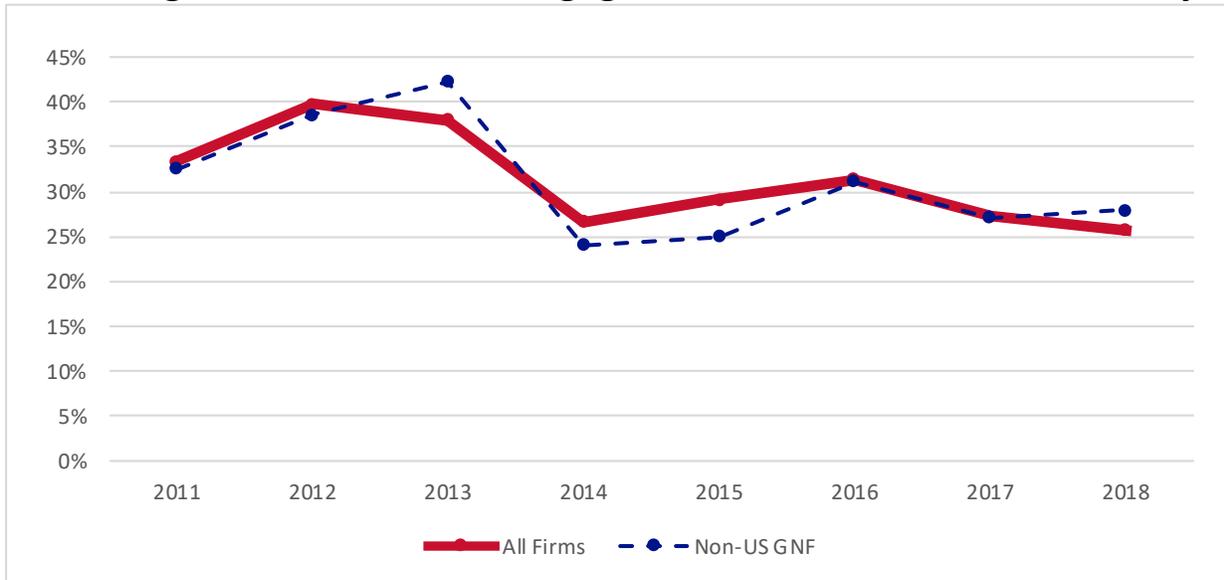
¹⁵³ A Part I.A deficiency is identified through inspection and included in a PCAOB inspection report when "the Board believes that the firm, at the time it issued its audit report, had not obtained sufficient appropriate audit evidence to support its opinion on the issuer's financial statements and/or 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 auditors¹⁶⁰ 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

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

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

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

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.

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.

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

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.

* * *

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.²For audits that involve other auditors or referred-to auditors, 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 engagements⁴ 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,^{264E} 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;

(12) 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

- (23) 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 eachc. 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.^{4E}

^{4E} 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.^{274G}

^{274G} 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,^{294H} 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 auditors and gain access to the other auditors's audit documentation.^{294I}

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

^{294H} 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.~~

^{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 committee⁶ 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 activities⁹ 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-.06~~ 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,⁴³ 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.

~~⁴³ 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 possibility¹⁶ 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 2201¹⁷ 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 auditors⁴⁸ 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.~~

~~⁴⁸ 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 accountants²⁰¹ 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.²⁴²

²⁰¹ See paragraph (a)(ii) in PCAOB Rule 1001, *Definitions of Terms Employed in Rules*, which defines the term “accountant.”

²⁴ ~~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 firm²²³ 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 ~~are~~ both:
 - (1) ~~are~~ 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) ~~are~~ Assist the engagement partner in fulfilling his or her planning or supervisory responsibilities on the audit pursuant to AS 2101 or AS 1201.²³⁴

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 secondees⁵ 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.

²²³ 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 2301.05a⁴~~ ~~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]uditor’s engagement team members should be assigned to tasks and supervised commensurate with their level of knowledge, skill, and ability”~~

⁵ For this purpose, the term “seconded” 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 units²⁴⁶ 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

²⁴⁶ 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 team¹ 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 Auditors¹⁴

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 accumulated²¹ ~~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.

~~e.~~ .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.~~

~~e.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 ~~.B2c09, .11, and .B2d of this appendix12~~), 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 ~~.B2a08 and .B2b10, 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.~~

²³¹⁸ 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 accountants¹⁴ 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 firm¹⁶ 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 1201.⁴⁷~~

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

~~⁴⁶ See paragraph (r)(i) in PCAOB Rule 1001, *Definitions of Terms Employed in Rules*, which defines the term "registered public accounting firm."~~

~~⁴⁷ 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.~~

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,⁴ the other auditors are responsible for performing their work with due professional care.~~

~~⁴ 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.~~

AS 1105, Audit Evidence

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.

AS 1215, *Audit Documentation*

Retention of and Subsequent Changes to Audit Documentation

.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.

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 auditor¹ regarding dividing responsibility for the audit of the company's financial statements² and, if applicable, internal control over financial reporting³ with a referred-to auditor.⁴

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

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

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.

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 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.~~⁵⁶

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 units⁶⁷ audited by the referred-to auditor into the company's financial statements.⁷⁸ 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

⁵⁶ The term "engagement team," as used in this standard, has the same meaning as defined in Appendix A of AS 2101.

⁶⁷ The term "business units" includes subsidiaries, divisions, branches, components, or investments.

⁷⁸ 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;⁸⁹
- 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;⁹¹⁰ 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)

⁸⁹ 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~~),^z 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.

⁹¹⁰ 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 ~~report~~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.⁴⁰¹¹

- 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

⁴⁰¹¹ ~~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;⁴⁴¹² 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.⁴⁴¹³

.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.

⁴⁴¹² 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.

⁴⁴¹³ 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.

~~Appendix~~**PPENDIX 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 firm¹³ 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 units¹⁵ 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.~~

~~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.~~

Appendix ~~PPENDIX~~ 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 Chooses¹ 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 Firm¹⁶

[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 ~~X~~ the Company’s internal control over financial reporting as of December 31, ~~20X3~~ 20X2, 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 maintaining each of the three years in the period ended December 31, 20X2, in conformity with accounting

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 control 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 ~~XXAA~~ percent, ~~YYBB~~ percent, and ~~ZZCC~~ 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. ⁴⁷²

[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

⁴⁷² 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 Statements³

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

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 opinions, 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 ~~XXAA~~ percent, ~~YYBB~~ percent, and ~~ZZCC~~ 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 24: 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 opinions, 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 ~~XXAA~~ percent, ~~YYBB~~ percent, and ~~ZZCC~~ 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.²For audits that involve other auditors or referred-to auditors, 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.^{4E}

^{4E} 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 committee⁶ 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 activities⁹ 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 Paragraphs ~~.06-.06I~~ 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.~~

~~¹³¹ [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 possibility¹⁶ 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 2201¹⁷ 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 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 accountants¹ 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 firm³ 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 secondees⁵ 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 units⁶ 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 team¹ 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}

~~4~~ Terms^{1A} The term “engagement partner” is defined in Appendix A, *Definitions*, and is 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 Auditors¹⁴

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 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

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~~.

AS 1105, Audit Evidence

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.

AS 1215, Audit Documentation

Retention of and Subsequent Changes to Audit Documentation

.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*.

AS 1220, Engagement Quality Review

.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.

AS 1301, *Communications with Audit Committees*

Obtaining Information and Communicating the Audit Strategy

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:

- d. The names, locations, and planned responsibilities¹² 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 participate 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.



Exhibit 2(a)(D)

Alphabetical List of Commenters on the Proposal in PCAOB Release No. 2016-002
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1	AngloGold Ashanti Limited
2	BDO USA, LLP
3	California Society of Certified Public Accountants
4	Center for Audit Quality
5	Crowe Horwath LLP
6	Deloitte & Touche LLP
7	Denise Hanes Downey; and Jean C. Bedard
8	Ernst & Young LLP
9	Federation of European Accountants (FEE)
10	Florida Institute of Certified Public Accountants
11	Grant Thornton LLP
12	Illinois CPA Society
13	Institut der Wirtschaftsprüfer (IDW)
14	KPMG LLP
15	Moss Adams LLP
16	National Association of State Boards of Accountancy (NASBA)
17	PricewaterhouseCoopers LLP
18	RSM US LLP
19	Texas Society of Certified Public Accountants
20	The Institute of Chartered Accountants in England and Wales (ICAEW)
21	U.S. Chamber of Commerce, Center for Capital Markets Competitiveness
22	United States Government Accountability Office (GAO)
23	Virginia Society of Certified Public Accountants

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05 July 2016

Public Company Accounting Oversight Board
 1666K Street, NW,
 Washington DC 20006-2803
 United States of America

By email: comments@pcaobus.org

Dear Sirs,

INVITATION TO COMMENT – PCAOB RULEMAKING DOCKET MATTER NO. 042

AngloGold Ashanti Limited is pleased to provide comments to the Public Company Accounting Oversight Board (the "PCAOB or the Board") on its proposed amendments relating to the supervision of other auditors PCAOB Release No 2016-002 (April 12, 2016) (the "Release").

AngloGold Ashanti Limited, headquartered in Johannesburg, South Africa, is a global gold company with a portfolio of long-life, relatively low-cost assets and differing orebody types in key gold producing regions. The company's 17 mining operations are located in 9 countries (Argentina, Australia, Brazil, Democratic Republic of Congo, Ghana, Guinea, Mali, South Africa and Tanzania) and are supported by extensive exploration activities in a number of countries around the world. The combined proved and probable ore reserves of the group amounted to 51.7 million ounces as at December 31, 2015 and currently a market capitalisation in excess of USD 6bn.

AngloGold Ashanti's American depository shares are listed on the New York Stock Exchange under the symbol "AU". As a well-known seasoned issuer and a foreign private issuer, AngloGold Ashanti files annual reports with the Securities and Exchange Commission ("SEC") on Form 20-F and furnishes its home jurisdiction periodic reports with the SEC on Form 6-K.

AngloGold Ashanti fully supports the aim of the proposed amendments relating to the supervision of other auditors as it has the potential to increase transparency in the interactions of the audit committee with the external auditors and thus assist investors in understanding and evaluating the role and performance of the audit committee and the lead auditors.

We have concerns, however, that the proposed amendments will have unintended consequences beyond those described in the Rulemaking Docket, including the potential for impacting the ability of the Audit Committee to perform its supervision role, increasing the costs and risk of leakage of market sensitive information during potential future transactions and by allowing the lead auditor to potentially deflect litigation liability at the cost of investor protection. We also recommend that identification by the lead auditor of matters of non-compliance with auditing standards by the referred-to auditor identified by the lead auditor be a reportable matter to the audit committee.

We believe that the points we raise to the questions you pose in the Rulemaking Docket will add to the necessary debate on this issue. As preparers of financial statements we are as interested as investors in ensuring that high quality audits are the norm for the industry and regard any audit that is not "high quality" as an automatic audit failure.

AngloGold Ashanti Limited

Reg No: 1944/017354/06

Directors: SM Pityana (Chairman) S Venkatakrishnan (British/Indian) (Chief Executive Officer) KC Ramon (Chief Financial Officer) R Gasant A Garner (American) DL Hodgson
 NP January-Bardill MJ Kirkwood (British) M Richter (American/Panamanian) Prof LW Nkuhlu RJ Ruston (Australian)
 Group General Counsel and Company Secretary: ME Sanz Perez



Notwithstanding the intent of the proposed amendments we need to guard against creating regulations that imply that compliance, in and of itself, guarantees high quality, as slavish adherence to checklists does not achieve high quality in anything, if it results in losing sight of the ultimate objective.

Without doubt, the lead auditor is ultimately responsible for the overall audit opinion and any delegation of this responsibility needs to be strongly discouraged and accordingly auditing standards which enforce this ultimate responsibility must be encouraged. The lead auditor must ensure that the global audit plan, for which he is responsible, is enforced by all participants assigned to work on the engagement and the Corporate entities must provide all the necessary resources to ensure that the lead auditor is unhindered in this objective. This symbiotic relationship will work towards ensuring a high quality audit is the ultimate outcome.

Circumstances where the lead auditor can delegate or otherwise shift responsibility for the high quality audit must be actively discouraged as only one auditor can be responsible for this objective. High quality by consensus responsibility is difficult to regulate, difficult to enforce and difficult to measure and thus processes which permit or otherwise encourage responsibility shifting effectively weaken regulation rather than enhancing.

Accordingly, although we support enhancing the lead auditor role and responsibility we do not support processes, such as referring to other auditors in the audit report. This referral process creates a perception that the "referred-to auditor" is responsible for such work and thus the lead auditor is blameless should an error or failure occur in the work performed by the "referred-to auditor".

"The buck stops here" not "The buck stops, there, there and over there".

Further, it is reasonably possible that an audit failure by the "referred-to auditor" may be incapable of a litigation remedy by the aggrieved shareholders assuming that the "referred-to auditor" has no place of business or any assets in the United States, thereby reducing investor ability to hold someone accountable for the audit failure.

It is our considered opinion that the proposed auditing standard has some very good and useful parts that will have the ability, if implemented thoughtfully, to improve the audit process and lead to a high quality audit. We also believe that the matters raised in the proposed standard are important to investors and will provide them with useful information.

Accordingly, we would recommend that the disclosure consequences of this proposed standard would be better served by including them as a Critical Audit Matter for inclusion as part of the Improving the Auditors Report proposals set out in PCAOB Release No. 2016-003 – PCAOB Rulemaking Docket matter No. 032 (Auditor Reporting Reform").

This process of implementation would provide investors with all of the useful information, would show how the lead auditor dealt with the consequences of reliance on the work of other auditors, without delegating any of the lead auditor responsibility for the overall audit opinion.

We have provided more detailed comments to your questions, where we believe we have a comment, in our appendix attached and are available should you wish to discuss any of our comments with us at a later date.

Yours faithfully

A handwritten signature in black ink, appearing to read "KC Ramon", is located below the "Yours faithfully" text.

KC Ramon
EVP: Finance & Group Financial Director



1. *Does the description of existing audit practice accurately depict the state of practice? Does the discussion of the reasons to improve auditing standards sufficiently describe the nature of concerns arising from the use of other auditors that the Board should address? Are there additional concerns that the Board should seek to address?*

As we are preparers of annual financial statements we have no comment on the description of existing audit practices.

We believe that should the lead auditor have concerns on the application of PCAOB standards on the work performed by other auditors, the lead auditor should be raising those concerns with those charged with governance of the entity, specifically the Audit Committee.

Part of the duties of the audit committee is to assess the work performed by the lead auditor and if necessary other auditors performing work in relation to the audit opinion. In South Africa, our legislation requires all "public interest companies"¹ to appoint an audit committee. In a group situation, the group audit committee may take on the responsibilities of subsidiary companies.

The audit committee would expect that a lead auditor should be reporting areas of deficiency in auditing standards by other auditors to the audit committee in the required reporting to those charged with governance undertaken by the lead auditor.

We would therefore recommend that where the lead auditor identifies, during the course of his work, non-compliance with auditing standards, which therefore required extending of work, either by the referred-to auditor or the lead auditor, that such identified deficiency is a reportable matter to the audit committee.

2. *Are these proposed amendments to existing standards appropriate? Are additional changes needed to increase the likelihood that the lead auditor is sufficiently involved in the other auditor's work? Should the Board require specific procedures to address business, language, cultural, and other differences between lead auditors and other auditors, and if so, what types of procedures?*

We support standards that increase the responsibility of the lead auditor in assessing the capabilities of those other auditors involved in the audit engagement. We believe that such work by the lead auditor needs to be undertaken early on in the engagement process to ensure that any identified deficiencies are identified and remediated. This would be a similar process that management adopts in identifying and remediating weaknesses identified in a SOX process.

We do not support that the lead auditor should explicitly refer to other auditors in the lead auditor's opinion. We believe that the lead auditor is appointed by the audit committee to perform a role, being to provide an opinion on the financial statements of the entity as a whole. This role is supervised by the audit committee in fulfilling their fiduciary duties.

By permitting the lead auditor to divide responsibility this may result in the audit committee being unable, except by incurring undue costs and time, to fulfill the supervision role they are expected to perform.

Furthermore, the process to be included for all PCAOB audit reports issued on or after 30 June 2017, wherein Form AP will identify:

- The name of the audit partner responsible for issuing the firm's audit report, and
- The name, location and extent of participation of other accounting firms whose participation exceeded 5% of the total audit hours

¹ A public interest company is determined by a formula that considers the following:

- Average number of employees
- Amounts owing to third parties at financial year-end
- Turnover/revenue
- Number of individual/entities with a beneficial interest in the issued securities.



will provide investors with the necessary information for them to assess the involvement of the lead auditor in the formulation of the audit opinion.

3. *Are there any other areas of improvement in existing standards relating to audits that involve other auditors that the board should address? Should the board's standards be amended to address other responsibilities of the lead auditor? Are there related areas of practice for which additional or more specific requirements are needed, such as determining tolerable misstatement for the individual locations or business units under AS 2105?*

We recommend that the PCAOB should consider this whole topic in the light of the proposals on "Auditor Reporting Reform". We believe that the strategy that the lead auditor considers in determining audit role and materiality is directly linked to the work allocated to other auditors and the level of reliance that the lead auditor places on other auditors. Thus we believe that it easily fits the requirements for assessment as a Critical Audit Matter and is appropriately discussed in this context.

You correctly point out that SEC rules require that the other accounting firm's reports be filed with the SEC (Rule 2-05 of Regulation S-X, 17 C.F.R.210.2-05). This does not come at no cost.

The entity filing the other accounting firm opinion with its Annual Report on Form 10-K or Form 20-F is required to obtain a consent letter from the other accounting firm. Prior to the issue of the consent, the other accounting firm is required to undertake various audit procedures not limited to reading the Form 10-K or Form 20-F, and conducting any necessary subsequent events reviews, amongst others.

Further, whenever the Form 10-K or Form 20-F is cross referenced with a Registration Statement, whenever the Issuer draws down on the Registration Statement the other accounting firm may be required to issue a further consent or even be involved in a comfort letter process with underwriters.

All of these extra procedures expand the net of individuals and entities that could be involved in a corporate transaction and unnecessarily increase the risk of potential leakage of market sensitive information, which would not be beneficial to investors.

Based on the above, we would not be supportive of any reference by the lead auditor to other auditors which trips the requirements of Rule 2-05 of Regulation S-X, 17 C.F.R.210.2-05, other than that already required.

We believe that in the event of an anticipated transaction the lead auditor may consider referring to other auditors in order to reduce audit risk which would have nothing to do with the risk for the actual audit opinion, but only the potential risk that may arise from the anticipated transaction.

We also believe that providing the lead auditor with the decision making power of referring to other auditors reduces the effectiveness of the audit committee's oversight responsibilities as the audit committee may have no relationship with the referred-to auditor and thus will receive no communication from the referred-to auditor. The referred-to auditor may also not wish to communicate with the audit committee of the entity directly in order to reduce litigation risk to third parties.

In some circumstances we believe there is a potential outcome, where the lead auditor refers to other auditors in the opinion with the objective of reducing litigation exposure. An example of this would be where the two firms, not part of the same global network, have different judgmental opinions. As US GAAP moves to a principles base similar to IFRS more judgment will be required in determining the applicable accounting treatment for a transaction. We can envisage a situation where one of the firms has a different "global network firm-wide" opinion on the accounting treatments than the other firm. This situation already exists in the global network firms IFRS guidance books. The lead auditor may elect to take the option of referring to the other auditor purely because the global network firm disagrees with the perfectly legitimate accounting interpretation.

This is not a desirable outcome for investor protection as it could create a perception that the referred-to firm is not in compliance with the required accounting literature whereas in reality the event is a different judgmental position.

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4. *The Board requests comment generally on the baseline for evaluating the potential economic impacts of the proposal. Are there additional academic studies or data the Board should consider? The Board is particularly interested in studies or data that could be used to assess potential benefits and costs.*

We have no comment on this matter.

5. *The Board requests comment generally on the analysis of the need for the proposal. The Board is interested in any alternative economic approaches to analyzing the issues presented in this release, including references to relevant data, studies, or academic literature.*

We have no comment on this matter.

A handwritten signature or set of initials is located in the bottom right corner of the page. The signature is written in black ink and appears to be a stylized 'al'.



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July 29, 2016

Via E-mail: comments@pcaobus.org

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

Re: PCAOB Release No. 2016-002, Rulemaking Docket Matter No. 042: *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard - Dividing Responsibility for the Audit with Another Accounting Firm*

Dear Office of the Secretary:

BDO USA, LLP appreciates the opportunity to respond to the request for comments on the Public Company Accounting Oversight Board's (the PCAOB or the Board) Release No. 2016-002: *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors* (proposed amendments) and *Proposed Auditing Standard - Dividing Responsibility for the Audit with Another Accounting Firm* (collectively, the Proposal). We support the PCAOB's efforts to strengthen the auditing standards relating to audits in which other auditors participate. As noted in the Proposal, supervision of other auditors presents unique challenges in ensuring an audit is performed in accordance with PCAOB standards, in particular, where other auditors operate in different countries with differing cultures, languages or economic markets, and for this reason, we support enhancing the PCAOB auditing standards to advance audit quality.

As the PCAOB works towards the development of amendments and a new standard relating to the use and supervision of other auditors, we encourage the PCAOB to continue to engage in a dialogue with the International Auditing and Assurance Standards Board (IAASB) to understand the successes and challenges in the implementation of International Auditing Standard (ISA) 600, *Special Considerations - Audits of Group Financial Statements (Including the Work of Component Auditors)*. As noted in the Executive Summary of the Proposal, the IAASB is currently assessing the implementation of ISA 600 and looking to strengthen the standard, and as such, has issued an Invitation to Comment.

In the IAASB's *Invitation to Comment - Enhancing Audit Quality in the Public Interest* (Invitation to Comment), the IAASB notes that regulators and audit oversight bodies have expressed concern about situations where the direction and supervision of the members of the engagement team do not appear adequate and the reviews of their work do not appear to have been performed properly. Similarly, concerns have been raised regarding the direction, supervision and review of the work of other auditors involved in the audit. Based on initial input from responses to the IAASB's Work Plan for 2015-2016 and input from other



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outreach activities, the IAASB is currently exploring whether changes to the requirements and guidance in the ISAs may be necessary in the following areas:

- Strengthening and clarifying how the full suite of ISAs apply in a group audit
- Acceptance and continuance
- Communications between the group engagement team and component auditors
- Using the work of component auditors
- Identifying and assessing risks of material misstatement in a group audit
- Responding to identified risks of material misstatement in a group audit, including issues relating to the group engagement team's involvement in the consolidation process
- Review and evaluation of the work of component auditors

We encourage the PCAOB to monitor the activities of the IAASB relating to this project and align with the IAASB's standards when possible to minimize unnecessary differences.

Our comments below align with the topical sections set out within the Proposal, and as such, our responses to the specific questions posed are addressed, as applicable, within those sections.

General Comments

Current PCAOB requirements relating to the use and supervision of other auditors in an audit are set forth in AU sec. 543 (reorganized as AS 1205), *Part of Audit Performed by Other Independent Auditors*, and Auditing Standard No. 10 (reorganized as AS 1201), *Supervision of the Audit Engagement*. While AS 1201 was adopted in 2010 as part of the suite of risk assessment standards and addresses the supervision of the audit engagement, AS 1205, last updated in 1972, has not kept pace with the changes in how global companies are structured or operate. Given the growth in the number of companies with global operations, coupled with the increased complexities in the way businesses operate and report financial results, an updated set of standards that reinforces the need for continuing communication and interactions among audit participants, including other auditors, throughout the audit is essential to enhancing audit quality.

While we support enhancing guidance in situations in which other auditors participate in an audit, we believe such enhancements should incorporate a risk-based approach in order to allow the lead auditor to apply professional judgment in developing an audit strategy. We note that the Executive Summary of the Proposal explains that the intention of the proposed amendments are meant to strengthen the PCAOB auditing standards by applying a risk based supervisory approach; however, we believe that the Proposal may be more prescriptive than necessary to achieve its objective. Our comments, in the following section, provide suggestions on how a more-risk based approach to supervision might be accomplished.



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Proposed Amendments to AS 1201, *Supervision of the Audit Engagement*

Communication of Risks of Material Misstatement

The proposed Appendix B to AS 1201, *Procedures to Be Performed by the Lead Auditor with Respect to the Supervision of the Other Auditors' Work*, details the procedures the lead auditor is required to perform regardless of assessed risk of material misstatement. We believe such an approach would result in additional work effort without a corresponding benefit. For example, paragraph B2 a. (2) requires the lead auditor to inform the other auditor of identified risks of material misstatement without regard to significance; in essence requiring communication of all risks of material misstatement. We believe such a requirement, without a significance filter and the use of professional judgment, could have a considerable impact and unintended consequence on the extent of work performed by the other auditor beyond what the lead auditor may have intended. To more closely align the proposed requirement with a risk based approach, we suggest modifying the requirement to require communication of *identified significant risks of material misstatement* of the consolidated financial statements, due to fraud or error, *which are relevant* to the work of the component auditor, and the communication of other risks of material misstatement based on the professional judgment of the lead auditor.

Review of Specified Documentation

The proposed Appendix B to AS 1201, paragraph B2 c. requires the lead auditor to direct the other auditor to provide for review of specified documentation with respect to the work requested, and AS 1215, paragraph 19 lists the documentation related to the work performed by other auditors that the lead auditor must obtain and review and retain, prior to the report release date. AS 1201, paragraph 6 then explains that as part of supervising the audit, the lead auditor would determine the extent of the additional review of the other auditor's work papers necessary. We agree that in certain circumstances, based on an assessment of risk, it would be appropriate for the lead auditor to request to review additional work paper documentation; however, we disagree with the explanation included within the Additional Discussion section of the Proposal (page A4-34). That explanation states, 'For example, the lead auditor could determine it necessary to request additional documentation for review with respect to the work performed by less experienced other auditors, or with respect to an area of heightened risk of material misstatement.' We do not believe the interpretation appropriately considers the extent of supervision and review performed by the engagement partner or senior level team member of the other auditor who oversaw the work performed by the other auditor engagement team members, and believe that the interpretation should be clarified in this regard.

Proposed Amendments to AS 1215, *Audit Documentation*

The proposed paragraph .19A of AS 1215 would add a requirement for the lead auditor to include in audit documentation a list of additional work papers of other auditors (beyond those described in paragraph .19) that were reviewed by the lead auditor but not retained that includes a description of the work papers reviewed. We believe the requirement to



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include a description of the work papers reviewed is unnecessary, and would result in incremental work effort that does not enhance audit quality. A list that includes the title of the work paper along with a reference to the audit step addressed should provide sufficient context to understand the purpose of the work paper.

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

We support the development of a separate standard related to dividing responsibility in an audit and the definition of a referred-to auditor. However, we note the Securities and Exchange Commission (SEC) does not use this term and it is unclear how the SEC's term 'principal accountant' aligns with the PCAOB's term, 'referred to auditor,' in situations where responsibility is divided. As such, we believe additional clarity is needed in this regard.

Furthermore, we note that proposed AS 1206 does not permit dividing responsibility in situations where the financial statements of the company's business unit audited by the referred-to auditor were prepared using a different financial reporting framework as the financial reporting framework used to prepare the company's financial statements. We believe this would be a change in practice, as extant standards allow for such reporting, and may have unintended consequences. Current practice allows making reference to another auditor when the measurement, recognition, presentation and disclosure criteria that are applicable to all material items in the subsidiary's financial statements under IFRS are similar to the criteria applicable to all material items in the consolidated financial statements and the lead auditor has obtained sufficient appropriate audit evidence for purposes of evaluating the appropriateness of the adjustments to convert the subsidiary's financial statements to U.S. GAAP. AICPA generally accepted auditing standards (AU-C 600, paragraphs .A54-.A56) provides additional application guidance to assist auditors in determining whether to make reference when the financial reporting framework is not the same, and we believe such guidance would be helpful to practitioners and should also be considered.

Proposed Amendments to AS 2101, *Audit Planning*

Lead Auditor Determination

The 'lead auditor' is defined in the Proposal as (a) the registered public accounting firm 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 (i) are partners, principals, shareholders, or employees of the registered public accounting firm issuing the auditor's report and (ii) assist the engagement partner in fulfilling his or her planning or supervisory responsibilities on the audit pursuant to AS 2101 or AS 1201. However, we believe that the definition needs to be broadened to recognize differing firm practices that may allow for personnel sharing between network firms, sometimes referred to as seconded employee arrangements. For example, in some firms, short-term seconded employees, those employed less than six



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months, may work on a U.S. public company engagement under the direct supervision of the U.S. engagement partner but retain their employment status with the foreign firm. Under the proposed definition, these seconded employees would be considered part of the other auditor and supervised in accordance with the specified procedures required for these team members due to their designation as 'other auditors.' Such an outcome would not be reflective of the day-to-day supervision of the engagement team, in particular of the seconded employee, and for this reason we believe that seconded employees should be considered part of the lead auditor.

Sufficient Participation to Serve as Lead Auditor

Proposed paragraph B2 of AS 2101 explains that in an audit that involves other auditors or referred to auditors, the engagement partner should determine whether the participation of the firm is sufficient to carry out the responsibilities of a lead auditor. In making this determination, the engagement partner is to take into account 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 portion audited by other auditors.

While we appreciate the examples provided in Appendix 4 of the Proposal, situations exist such that the circumstances surrounding the determination of sufficiency of the participation of the lead auditor is not always as clear. We note that the IAASB is currently addressing this issue as part of the IAASB's Invitation to Comment. The Invitation to Comment suggested that consideration could be given to clarifying the expected performance requirements for individuals other than engagement partners who sign or who are named in the auditor's report. As an example, they explain that such individuals could at a minimum be expected to perform the same procedures that an EOC reviewer would perform.

We encourage the PCAOB to work with the IAASB in addressing this matter and arriving at a consistent approach.

Understanding the Knowledge, Skill and Ability of Other Auditors

The proposed definition of an engagement team includes other accounting firms who perform audit procedures on an audit or assist the engagement partner in fulfilling his or her planning or supervisory responsibilities. As a result, the requirement in AS 1201, paragraph 6 that directs the engagement partner and other team members performing supervisory activities to take into account the knowledge, skill and ability of each engagement team member in determining the extent of supervision, by definition includes supervision of other auditors. We believe that in applying this requirement, the lead auditor should be permitted to apply a risk-based approach as it relates to the other auditor, such that the extent of the lead auditor's procedures to obtain an understanding of the other auditor and the resulting supervision would be less when the lead auditor has determined that the other auditor (1) consistently applies common quality control and monitoring policies and procedures and a common audit methodology, or (2) operates in the same jurisdiction as the lead auditor or



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the lead auditor has prior experience with the other auditor. Applying such an approach would balance the extent of supervision with the assessed risks.

Other Comments

Other Auditor Responsibilities

We note that the Proposal is focused solely on the requirements of the lead auditor; however, we believe that the two-way communication between the lead auditor and the other auditor could be strengthened, and audit quality improved, through the development of a framework or standard focused on enhancing communication and interaction between the two parties. Additionally we note in practice that there are no formal inter-office reporting requirements and, as a result, the quality of reporting varies. We believe the Board should develop guidance on the content and format of inter-firm reports to promote consistency and help lead auditors understand the work performed and the responsibility taken by the other auditor.

Emerging Growth Companies and Applicability of Proposed Requirements to Audits of Brokers and Dealers

We support applying the proposed amendments and new standard to emerging growth companies (EGCs) and brokers and dealers that are required to conduct audits in accordance with PCAOB standards, as we believe the benefits resulting from the Proposal would outweigh any additional costs.

* * * *

We appreciate your consideration of our comments and suggestions and would be pleased to discuss them with you at your convenience. Please direct any questions to Chris Smith, National Accounting & Auditing Professional Practice Leader at 310-557-8549 (chsmith@bdo.com), Susan Lister, National Director of Auditing at 212-885-8375 (slister@bdo.com), or Patricia Bottomly, National Assurance Partner at 310-557-8538 (pbottomly@bdo.com).

Very truly yours,

/s/ BDO USA, LLP

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July 21, 2016

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**Subject: Comments on PCAOB Rulemaking Docket Matter No. 042
Proposed Amendments Relating to the Supervision of Audits
Involving Other Auditors, and Proposed Auditing Standard –
Dividing Responsibility for the Audit with Another Accounting Firm**

The California Society of CPA's ("CalCPA") Accounting Principles and Assurance Services Committee ("the Committee") is the senior technical committee of CalCPA. CalCPA has approximately 43,500 members. The Committee consists of 55 members, of whom 45 percent are from local or regional CPA firms, 32 percent are from large multi-office CPA firms, 12 percent are sole practitioners in public practice, 6 percent are in academia and 5 percent are in international CPA firms. Members of the Committee are with CPA firms serving a large number of public and nonpublic business entities, as well as many non-business entities such as not-for-profits, pension plans and governmental organizations.

The Committee is pleased to support the efforts of the PCAOB in clarifying the audit standards regarding shared audits and presents our responses to the PCAOB's questions.

II. Background and Reasons to Improve Auditing Standards

C. Reasons to Improve Auditing Standards

1. Does the description of existing audit practice accurately depict the state of practice? **Yes**

Does the discussion of the reasons to improve auditing standards sufficiently describe the nature of concerns arising from the use of other auditors that the Board should address? **Yes**

Are there additional concerns that the Board should seek to address? *Not with respect to the overall objective of the PCAOB, but the Committee will comment on specific sections of the new or amended standards below.*

III. Discussion of Proposed Amendments

B. Propose a New Auditing Standard for Dividing Responsibility

2. Are these proposed amendments to existing standards appropriate? *Yes, changes are needed to clarify the role of the lead auditor in supervising the work of other auditors.*

Are additional changes needed to increase the likelihood that the lead auditor is sufficiently involved in the other auditor's work? *No, the direction of the current proposal is sufficient to achieve a greater uniformity in practice among audit firms and their personnel who perform these types of engagements.*

Should the Board require specific procedures to address business, language, cultural, and other differences between lead auditors and other auditors, and if so, what types of procedures? *Not directly, other than to acknowledge the lead auditor ought to consider such conditions in developing the overall audit plan so that it can be effectively implemented. The most significant issue deals with determining the other audit firm's understanding of the PCAOB audit process to properly execute their portion of the audit. It is possible the proposed new standards may ultimately cause some non-network firms to be dropped from the mix of available firms who provide services to the lead PCAOB registered firms. We do not consider this an unacceptable result.*

3. Are there any other areas of improvement in existing standards relating to audits that involve other auditors that the Board should address? *Not at this time.*

Should the Board's standards be amended to address other responsibilities of the lead auditor? *No.*

Are there related areas of practice for which additional or more specific requirements are needed, such as determining tolerable misstatement for the individual locations or business units under AS 2105? *No, the Committee believes the existing guidance contained in AS 2105 can be readily adapted to the use of other auditors.*

IV. Discussion of Proposed Amendments

A. Baseline

4. Quality of Audits That Use Other Auditors

4. The Board requests comment generally on the baseline for evaluating the potential economic impacts of the proposal. Are there additional academic studies or data the Board should consider? The Board is particularly interested in

studies or data that could be used to assess potential benefits and costs. *The Committee is not prepared to provide input in this area.*

B. Need for the Proposal

5. The Board requests comment generally on the analysis of the need for the proposal. The Board is interested in any alternative economic approaches to analyzing the issues presented in this release, including references to relevant data, studies, or academic literature. *The Committee believes the three bullets on Page 34 accurately summarize the likely economic impact on audit firms who currently use other auditors, and is not prepared to provide additional input in this area.*

C. Economic Impacts

1. Benefits

6. The Board requests comment generally on the potential benefits to investors and the public. Are there additional benefits the Board should consider? *No.*

2. Costs

7. The Board requests comment generally on the potential costs to auditors and companies they audit. Are there additional costs the Board should consider? *Please see the Committee's response to Question 5 above.*

3. Unintended Consequences

8. The Board requests comment generally on the potential unintended consequences of the proposal. Are the responses to the potential unintended consequences discussed in the release adequate? *Yes.*

Are there additional potential unintended consequences that the Board should consider? If so, what responses should be considered? *The Committee does not believe there are additional unintended consequences that might arise from implementing this proposal.*

9. Could the proposed requirement for lead auditor supervision diminish (or be perceived as diminishing) the other auditor's accountability for the work the other auditor performs? If so, are any changes to the proposal needed to describe the other auditor's responsibilities? *The Committee believes the proposed standards should improve the overall quality of the other auditor's work by providing the lead auditor the means to achieve more effective supervision and a greater precision in documenting the review of the other auditor's work. The Committee believes these changes will lead to a likely increase in the other auditor having more accountability, rather than less.*

10. Could the proposed requirement for lead auditor supervision induce lead auditors in some audits to divide responsibility with another accounting firm rather than supervise the accounting firm? If so, how often might this division of responsibility occur? *The Committee considers this a slight possibility. However, it would be unlikely, as managing SEC filings with a divided registered CPA firm under a split responsibility is cumbersome for the issuer.*

D. Alternatives Considered

11. The Board requests comment generally on the alternative approaches that the Board considered but is not proposing, as described in this release. Are any of these approaches, or any other approaches, preferable to the approaches the Board is proposing? What reasons support those approaches over the approaches the Board is proposing? *The Committee believes the current proposal is the best means of achieving the desired result.*

12. Are there additional economic considerations associated with this proposal that the Board should consider? If so, what are those considerations? *The Committee has no input on this question.*

V. Considerations for Audits of Emerging Growth Companies

13. The Board requests comment generally on the analysis of the impacts of the proposal on EGCs. Are there reasons why the proposal should not apply to audits of EGCs? If so, what changes should be made so that the proposal would be appropriate for audits of EGCs? What impact would the proposal likely have on EGCs, and how would this affect efficiency, competition, and capital formation? *The Committee is not in favor of creating a tiered audit process between EGC's and seasoned issuers. It is this Committee's experience that EGC's are actually less likely to have material geographic diversity of operations, and for those that do, the lead auditor should have to follow the same standard to insure the overall adequacy of the collective audit.*

VI. Applicability of the Proposed Requirements to Audits of Brokers and Dealers

14. The Board requests comment generally on the analysis of the impacts of the proposal on audits of brokers and dealers. Are there reasons why the proposal should not apply to audits of brokers and dealers? Are there any factors specifically related to audits of brokers and dealers that should affect the application of the proposal to those audits? *The Committee is not prepared to comment on the impact of the proposal on the audit of brokers and dealers who operate in diverse geographic locations.*

VII. Effective Date

15. How much time following SEC approval would accounting firms need to implement the proposed requirements? *The Committee suggests at least twelve to eighteen months at a minimum.*

APPENDIX 4

Additional Discussion of Proposed Amendments and Proposed New Standard

II. Terminology – Proposed Definitions

16. Are the proposed definitions of: (a) "engagement team," (b) "lead auditor," (c) "other auditor," and (d) "referred-to auditor" appropriate? *Yes.*

Do the proposed definitions clearly describe individuals and entities that are included in these definitions? *Yes.*

Is it clear which individuals or entities are not included in these definitions? If not, what changes to the proposed definitions are necessary? *The distinctions are adequately described.*

17. Some global network firms use short-term (several months) personnel sharing arrangements, during which some available personnel are seconded to other firms and function as their employees. Some firms contract with consulting firms or temporary workforce agencies for personnel that work alongside and in the same capacity as personnel on the engagement team that are employed by the lead auditor. Should these personnel be treated as part of the lead auditor? *The Committee believes those individuals performing substantive audit procedures under the direct supervision of the lead auditor (on an engagement specific or time frame basis) should be treated as part of the lead auditor. However, the Committee has observed that certain temporary or offshore staffing arrangements are structured in such a way that the work performed consists of rudimentary tasks that are reviewed by local supervisory personnel prior to being submitted to the lead auditor. In such cases, these individuals perform tasks that some might argue are really clerical in nature, and do not lead to material conclusions. Therefore, the Committee believes the proposed standard should provide the means to exclude such individuals from consideration as part of the lead auditor or engagement team.*

18. Are there any situations in practice where applying the new definitions of "engagement team" and "other auditor," including related requirements, would present practical challenges? *The Committee believes that including temporary workers, including the typical offshore staffing arrangements discussed in the Committee's response to Question 17 in the definition of the engagement team could present unnecessary practical challenges.*

19. Should there be requirements for the lead auditor to: (1) specifically identify the engagement team members responsible for assisting the engagement partner of the lead auditor in fulfilling his or her supervisory responsibilities and (2) document such assignments? *Yes.*

Should the individuals who assist the engagement partner with supervision be limited to engagement team members from the office issuing the auditor's report? *No, as the current use of secure electronic networks make the physical presence of all engagement members in a single office unnecessary.*

20. To emphasize the importance of assigning the proposed planning and supervision requirements to personnel with the appropriate qualifications in audits involving other auditors, the proposed definition of "lead auditor" references existing standards that describe making appropriate assignments of engagement responsibilities. Does this reference appropriately address the responsibility to seek planning and supervision assistance from qualified engagement team members in these situations? *The proposed planning and supervision requirements are sufficiently clear in this regard.*

III. Proposed Amendments to AS 2101 (Audit Planning)

21. The proposed requirements for determining whether a firm's participation is sufficient for it to serve as the lead auditor depend on the risks of material misstatement associated with the portion of the financial statements audited by the firm. (These requirements would apply regardless of whether the other auditor is from the same audit network as the lead auditor.) Should the Board consider alternative or additional criteria for determining whether a firm's participation is sufficient? For example, should the Board impose a quantitative threshold or specify criteria covering the locations of the company's principal assets, principal operations, or corporate offices? How would such criteria help address specific issues in practice? *While the proposed amendments to AS 2101, including the superseding of AS 1205 are appropriate, the Committee has serious concerns regarding whether developing some form of quantitative guidance (or floor) for determining if a firm can be the lead auditor under the PCAOB's risk based audit process could be effectively implemented in practice. The Committee suggests the PCAOB look to the results of inspection findings to determine if having a quantitative standard would have altered the determination of the lead auditor in practice.*

22. What are the practical challenges with applying the proposed engagement partner's determination of the firm's sufficiency of participation in the audit? What changes, if any, should be made to address those challenges? *In the Committee's experience, these situations are relatively clear, and the proposed standards will serve to enhance existing practice, rather than creating difficult new challenges.*

23. Are there situations in practice in which the proposed sufficiency determination would cause changes in the firm serving as lead auditor? If so, what are these situations? What are the potential effects of those changes, including potential effects on costs and audit quality? What changes to the proposal, if any, would mitigate these issues? *The Committee believes that the proposed standards could likely remove those who have failed to audit a reasonable majority of the client's business operations from continuing to serve as a lead auditor. The Committee believes this is a likely positive output, and sees no reason to try and mitigate it.*

24. The proposed sufficiency determination would apply for audits in which the lead auditor supervises the work of other auditors and audits in which the lead auditor divides responsibility for the audit with another firm. Should there be different requirements for the divided-responsibility scenario, for example, should there be additional criteria that require increased lead auditor participation in a divided responsibility scenario? If so, what should those requirements be? *The Committee does not see the need to create different requirements for a divided-responsibility scenario.*

25. Are the proposed requirements for the lead auditor to hold discussions with and obtain information from other auditors and referred-to auditors to identify and assess the risks of material misstatement appropriate and clear? Are there any practical challenges with this requirement? If so, what are they, and how could the proposed requirements be revised to address the challenges? *The Committee believes the proposed guidance is sufficiently clear.*

26. Are the additional proposed requirements for the lead auditor when planning an audit that involves other auditors, which address independence and ethics; registration; and qualifications of and communications with other auditors, appropriate and clear? Are there requirements that should be added to or removed from Appendix B of AS 2101? If so, what are those requirements and why should they be included or excluded? *The Committee believes the proposed guidance is sufficiently clear.*

27. The proposed amendments require the lead auditor to gain an understanding of each other auditor's knowledge of the SEC and PCAOB independence and ethics requirements and their experience in applying the requirements. Are there any additional costs or practical challenges associated with this? If so, what are they, and how could the proposed requirements be revised to mitigate these issues? *The Committee supports the Board's increased attention to this matter. The Committee believes that firms who register with the PCAOB but do not actually audit issuer clients directly in a relevant industry might not be suitable for the role as the other auditor. Therefore, the Committee does not believe the additional costs should be mitigated.*

28. Should the requirement for the lead auditor to gain an understanding of the knowledge, skill, and ability of the other auditors be limited to engagement team members who assist the lead auditor with planning and supervision? *No, it is relevant to obtain such information regarding the relevant skills of the entire engagement team, including obtaining their firm biographical information. The Committee sees no need to create a lesser standard than the lead auditor would apply in assigning staff to the lead engagement team.*

29. Are the proposed requirements to determine that the lead auditor is able to communicate with the other auditors and gain access to their work papers appropriate and clear? If not, what changes to the proposed requirements are necessary? *The Committee believes the proposed requirements are clear.*

30. Are the proposed amendments to the requirements for determining the locations and business units at which audit procedures should be performed clear and appropriate? *The Committee believes the lead auditor's audit of the location at which the primary financial reporting decisions are made as well as a sufficient number of other locations to cover a greater portion of the attendant audit risks is a reasonable general standard.*

IV. Proposed Amendments to AS 1201 (Supervision of the Audit Engagement)

31. Are the proposed procedures to be performed by the lead auditor with respect to the supervision of the other auditor's work appropriate and clear? If not, how should the proposed requirements be revised? *The Committee believes the proposed procedures to be performed are sufficiently clear and scalable.*

32. Currently, AS 1205.12 describes certain procedures that the lead auditor should consider performing when using the work of the other auditor (e.g., visiting the other auditor), which are not included in the proposal. Should the lead auditor be required to perform these or any other procedures? If so, what additional procedures should be required? *The Committee believes that modifying the AS 1205.12 requirement to consider visiting the other auditor a reflection of the worldwide spread of electronic networks and paperless audits. However, the Committee is aware of the desirability of having the lead auditor's senior engagement members (typically the lead partner) visit the foreign-based operation to gather relevant information first hand and to meet and review the work of in-network affiliates. The Committee suggests that practical guidance be provided in this area; as such additional procedures should be at the professional discretion of the lead auditor.*

33. Are the requirements for the written report from the other auditor sufficiently clear? *Yes.*

Are these requirements appropriately scalable to the nature and significance of the work referred to the other auditor? *Yes.*

Would the proposed requirement for the lead auditor to obtain a written report from the other auditor result in a significant change in practice? *It might within the population of lead registered public accounting firm's that shift a disproportionate amount of work to foreign-based non-network other auditors.*

If so, what is the estimated economic impact (e.g., costs and benefits) of this change? *The Committee is not in a position to comment on this question.*

34. Is the scalability of the proposed supervision amendments clear and appropriate? If not, what changes are necessary? *The Committee believes the proposed supervision requirements are clear and appropriate.*

Are the proposed requirements for situations in which the lead auditor directs another auditor to perform supervisory procedures with respect to a second other auditor on behalf of the lead auditor clear? If not, how should the proposed requirements be revised? *The Committee believes the proposed requirements are doable in practice.*

35. In a multi-tiered audit where the lead auditor directs the first other auditor to perform certain procedures with respect to the second other auditor, is the proposed requirement that lead auditor inform directly all other auditors of certain other specific matters appropriate? If not, how should the proposed requirements be revised? *The Committee believes the proposed requirements are sufficiently clear.*

36. In a multi-tiered audit, is the proposed requirement for the lead auditor to evaluate the first other auditor's supervision of the second other auditor's work clear? If not, how should the proposed requirements be revised? *The Committee believes the proposed requirements are sufficiently clear.*

37. Do the proposed requirements sufficiently cover the types of multi-tiered structures used today? If not, what other multi-tiered structures are used and what changes are needed to appropriately cover those situations? *The Committee is not prepared to respond to this question.*

38. Do issues exist when the lead auditor directs another auditor to perform supervisory procedures with respect to a second other auditor on behalf of the lead auditor that should be addressed in AS 2101, for example, with respect to the qualifications of other auditors? What are the issues and what proposed requirements should be added to appendix B of AS 2101? *The Committee believes the requirements to evaluate the qualification of the other auditors be extended to a second other auditor as well. The Committee also believes these*

matters are best managed by the lead auditor, assisted, if necessary by the first other auditor.

39. Should certain of the proposed supervision procedures be required to be performed by individuals at the office issuing the auditor's report versus the firm issuing the auditor's report? If so, which procedures? Why should such required procedures be confined to individuals located at a particular office of the firm issuing the auditor's report? *As we stated in our response to Question 32 above, there is no need to require that certain procedures only be performed in the physical office issuing the audit report.*

40. Do the proposed requirements provide sufficient emphasis on the need for two-way communication between the lead auditor and the other auditor throughout the audit? If not, what changes to the requirements are necessary to further promote such communication? *The Committee believes the need for two-way communication is clearly emphasized in the proposal.*

V. Proposed Amendments to AS 1215 (Audit Documentation)

41. The proposed requirement in AS 1215.19A is designed to provide additional information about the review of working papers performed by the lead auditor. Is the proposed requirement appropriate and clear? Why or why not? What other information about the review of the working papers performed by the lead auditor would be appropriate? *The Committee believes the proposed requirement is appropriate and clear. The extent of the lead auditor's documentation should be scalable. If the other auditor is an in-network member, both firms may be using the same audit manuals and guidance materials. Using an affiliate from within an association that does not require a uniform audit approach or an out-of-network firm might require enhanced documentation.*

42. The proposal does not require that the lead auditor make a list of all documents in the other auditor's files, including those not reviewed by the lead auditor. Should the lead auditor be required to document work papers in the other auditor's files that the lead auditor has not reviewed? *No, a general description should suffice.*

Would such a requirement improve audit quality? *Not necessarily.*

What potential costs or unintended consequences, if any, would be associated with such a requirement? *Any additional costs should be nominal under either case and the Committee is unaware of any unintended consequences.*

What practical difficulties would there be in complying with such a requirement? *The ability to put the listing together prior to the completion of field work if there is a tight deadline.*

43. In addition to the information currently in AS 1215.19, should the office issuing the auditor's report be required to obtain, review, and retain other important information supporting the other auditor's work, e.g., (1) information about related parties or relationships or transactions with related parties previously undisclosed to the auditor or determined to be a significant risk; or (2) information about 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? *Yes, these are the types of transactions the lead auditor ought to be informed about, so that additional information can be obtained. Effective two-way communication is critical in dealing with this type of information.*

44. In addition to the information currently in AS 1215.19g about all significant deficiencies and material weaknesses in internal control over financial reporting, should the office issuing the auditor's report be required to obtain, review, and retain information about all control deficiencies identified by other offices of the firm and other auditors? *The Committee believes that the lead auditor should have sufficient flexibility in determining how internal control deficiencies ought to be communicated. If an integrated audit is being performed, the Committee believes that communicating all control deficiencies is necessary to a comprehensive understanding of the client's foreign-based operations.*

VI. Proposed Amendment to AS 1220 (Engagement Quality Review)

45. Should there be a requirement (as proposed) for the engagement quality reviewer to focus the reviewer's attention on the engagement partner's determination of the firm's sufficiency of participation in the audit? *Yes.*

46. Are there any additional engagement quality review procedures that should be required for audits that involve "other auditors" or "referred-to auditors" (as proposed to be defined)? *No*

VII. Proposed New Standard for Audits that Involve Referred-to Auditors

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

47. Are the objectives of the proposed new standard clear and appropriate? If not, what changes are necessary? *The objectives are clearly stated.*

48. Are the proposed requirements for performing procedures with respect to the audit of the referred-to auditor clear and appropriate? If not, what changes are necessary? *The proposed requirements are clear.*

49. Are the conditions included in paragraph. 06 of the proposed new standard clear and appropriate? Are there other conditions that should be met for the lead auditor to divide responsibility with a referred-to auditor? *The conditions stated are clear, however, we suggest the definition of the phrase "play a substantial*

role in the preparation or furnishing of an audit report” be expanded upon in the proposed new standard.

50. Paragraph .07 of the proposed new standard describes the lead auditor's course of action in situations in which the lead auditor cannot divide responsibility. Are the requirements in this paragraph clear and appropriate? Why or why not? Are additional requirements necessary for such situations? *The Committee believes that issuing a qualified opinion or disclaimer as suggested in paragraph .07 b. are theoretical, but unrealistic options in current practice as such reports are unacceptable to the SEC for issuers. It would appear such situations ought to be rare in practice, given the need for advance planning of the audits of entities that have diverse geographic locations, material business acquisitions, etc. It would appear that option a. or c. are the only practical alternatives.*

51. An unintended consequence of the Board's proposal, described earlier in this release, is the potential increase in the use of the divided responsibility model by auditors. Should the Board prohibit divided responsibility arrangements or impose further limitations on them, such as limiting them to equity method investees or situations in which the referred-to auditor covers only a small portion of the consolidated assets or operations? If so, what would be the costs and benefits of such a prohibition or limitation? *The Committee strongly opposes imposing any prohibitions on the use of the divided responsibility model. The exercise of professional judgment by the audit profession should be allowed to develop in this area.*

C. Making Reference in the Lead Auditor's Report to the Audit and Auditor's Report of the Referred-to Auditor

52. Are additional requirements, including supervisory requirements, necessary to describe responsibilities of the lead auditor in situations in which the lead auditor divides responsibility for the audit with another accounting firm? Are there any other situations that would present challenges with the application of the proposed requirements? *None that the Committee is aware of.*

VIII. Other Considerations

A. Proposal to Supersede AI 10 (currently AU sec. 9543, *Part of Audit Performed by Other Independent Auditors: Auditing Interpretations of Section 543*), *Part of the Audit Performed by Other Independent Auditors: Auditing Interpretations of AS 1205*

53. Is superseding AI 10 appropriate, or is the interpretation necessary to fully describe the auditor's responsibilities under PCAOB standards? *The Committee suggests the interpretation be carried forward through a proposed amendment to AS 2110.*

B. Proposed Amendments Relating to Inquiries About Professional Reputation and Standing

54. Are the other proposed amendments relating to inquiries about professional reputation and standing of other auditors appropriate and clear in the context of each requirement? If not, what further amendments should the Board consider making to this requirement to improve its clarity? *Yes, provided the requirements to evaluate the qualification of the other auditors is extended to a second other auditor as we suggested in our response to Question 38.*

IX. Additional Questions Regarding Certain Aspects of the Proposal

55. Are the proposed conforming amendments in Appendix 3 appropriate and clear? Why or why not? What changes to the amendments are necessary? *The Committee believes the proposed amendments are appropriate,*

56. In addition to the proposed conforming amendments in Appendix 3, are other conforming amendments necessary in connection with the proposed changes to AS 1201, AS 1215, AS 1220, and AS 2101? *None that the Committee is aware of.*

57. Paragraph .10d of AS 1301 (currently Auditing Standard No. 16), *Communications with Audit Committees*, describes requirements regarding the lead auditor's communication to the audit committee of certain information about the other auditors. Should the lead auditor's communication to the audit committee with respect to the lead auditor's or other auditors' responsibilities in an audit be more specific than is currently required? If so, what additional information should the lead auditor communicate? *The Committee believes the lead auditor's communication should specify by name the other auditors (and the second other auditor, if any), their role in the overall audit, and whether any issues arose as a direct result of their participation, and how the issues were resolved by the lead auditor. The need to utilize other auditors might be considered as a critical audit matter under the PCAOB's proposed auditor's reporting standard.*

58. Because the Board's proposal focuses on audit engagements, it does not include amendments for engagements other than audits. Should the proposal include changes for reviews of interim financial information under AS 4105, *Reviews of Interim Financial Information* (currently AU sec. 722, *Interim Financial Information*) that involve "other auditors" or "referred-to auditors" (as proposed to be defined)? If so, what additional changes are needed? *The Committee has a couple of thoughts on the subject of interim reviews:*

- 1. If the interim review cannot be completed without the assistance of other auditors, the lead auditor ought to be communicating that in their discussion of the annual services plan with the client.*

2. If a report is intended to be issued on the interim financial information, many of the issues discussed in the Board's current proposal may be relevant as well. However, as the inquiry and analytical procedures expected to be performed are substantially less in scope than a financial audit, a scalable solution should be sought.

3. The Committee believes the Board should evaluate the applicability of the proposed guidance to interim reviews so that any amendments to AS 4105 can be made at the same time the audit literature is amended.

59. Is it sufficiently clear when AS 1201 (as proposed to be amended) or proposed AS 1206 – as opposed to AS 2503 – would apply to an audit of a company's equity method investment or other investments in an entity whose financial statements are audited by another accounting firm? If not, what change or guidance is needed? *The Committee believes the point the Board is trying to make is not clear, and should be clarified.*

We thank you for the opportunity to comment on this matter. We would be glad to discuss our opinions with you further should you have any questions or require additional information.

Sincerely,

A handwritten signature in black ink that reads "A.J. Major III". The signature is written in a cursive style with a large initial "A" and "J" and a stylized "Major III".

A.J. Major III
Chair
Accounting Principles and Assurance Services Committee
California Society of Certified Public Accountants



July 29, 2016

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Re: PCAOB Release No. 2016-002, Rulemaking Docket Matter No. 042: Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Accounting Firm

Dear Office of the Secretary:

The Center for Audit Quality (CAQ) is an autonomous public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. The CAQ fosters high quality performance by public company auditors, convenes and collaborates with other stakeholders to advance the discussion of critical issues requiring action and intervention, and advocates policies and standards that promote public company auditors' objectivity, effectiveness, and responsiveness to dynamic market conditions. Based in Washington, DC, the CAQ is affiliated with the American Institute of CPAs.

The CAQ welcomes the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or the Board) *Release No. 2016-002: Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors (proposed amendments) and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Accounting Firm* (collectively, the Proposal). This letter represents the observations of the CAQ, but not necessarily the views of any specific firm, individual, or CAQ Governing Board member.

The CAQ shares the PCAOB's goal of improving audit quality and supports the PCAOB's consideration of revisions to auditing standards guiding the supervision of other auditors as public companies and their auditors become increasingly global. In this letter, we offer for the Board's consideration our views regarding certain topics outlined in the Proposal. Our views are organized into the following sections:

- I. General Views
- II. Key Themes
- III. Comments on Appendix 1 - *Proposed Amendments Relating to the Performance of Audits Involving Other Auditors*
- IV. Comments on Appendix 2 - *Proposed AS 1206: Dividing Responsibility for the Audit with Another Accounting Firm*
- V. Other Comments

I. General Views

The CAQ agrees that current professional standards regarding the use of other auditors should be the subject of outreach and enhancement. Changes in the business environment, company organizational structures, accounting firm structures, financial reporting standards, and regulatory reporting requirements have all contributed to the need to revisit current standards. We agree the level of interaction among the lead auditor and other auditors is important to audit quality. Overall, we support actions that lead to increased communications among the lead auditor and other auditors that promote audit quality and the Board's focus on enhancing and refining requirements in this area.

We understand that the intent of the Proposal is for the approach to supervision of other auditors by a lead auditor be risk-based.¹ We support this approach, as it would provide the lead auditor the ability to exercise professional judgment and align supervisory efforts with the areas of higher risk. We believe there are additional opportunities to promote a risk-based supervision model by:

- focusing on significant risks to the consolidated financial statements that are present at the component level and other risks the lead auditor judges necessary;
- clarifying how the lead auditor can exercise professional judgment in varying the nature, timing, and extent of supervisory activities based on the significance of the assessed risks of material misstatement being addressed by the other auditor, the lead auditor's understanding of the knowledge, skill and ability of other auditors who assist the engagement partner with supervision; and
- considering the presence and effectiveness of a firm's system of quality control.

As noted in the *Current Practice* Section II.B of the Proposal, many larger and medium-sized firms have expended significant effort over the past few years to develop methodologies that are responsive to inspection findings, as well as that comply with International Standard on Auditing 600, *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)* (ISA 600), in addition to the standards of the PCAOB. The requirements of ISA 600 are more detailed, and, as a result, those firms are often performing audit procedures that go beyond the current requirements of extant PCAOB Auditing Standard 1205 (currently AU sec. 543), *Part of the Audit Performed by Other Independent Auditors* (AS 1205). However, other firms may comply only with the existing requirements of AS 1205. In considering the nature of certain requirements in the Proposal, even firms currently going beyond the extant standard will be impacted; as such, we believe it is important for the Board to recognize that certain proposed requirements will have a pervasive impact on the level of effort and costs for many, if not all, audits involving other auditors, both as it relates to implementation and ongoing efforts.

II. Key Themes

Evaluation of the Other Auditor

The Proposal includes the other auditor in the definition of the engagement team, and sets forth that the extent of supervision is expected to be determined in part by factors detailed in paragraph .06 of PCAOB Auditing Standard 1201 (currently Auditing Standard No. 10), *Supervision of the Audit Engagement* (AS 1201). One such factor is the knowledge, skill and ability of *each* engagement team member, which includes the other auditor.² This determination by the lead auditor is a key element in applying a risk-based approach to

¹ Page 5 of the Proposal

² AS1201.06(d)

the supervision of other auditors. However, we are concerned that certain requirements in the Proposal are prescriptive such that it is not clear how the lead auditor will be able to vary the nature, timing, and extent of supervision based on the significance of the assessed risks of material misstatement being addressed by the other auditor, and the understanding of the knowledge, skill and ability of other auditors who assist the engagement partner with supervision. The Board should consider identifying factors for the lead auditor to consider when evaluating the knowledge, skill and ability of the other auditor³, and modifying Appendix B to AS1201 to clarify how such factors can affect the extent to which activities required by Appendix B are performed. We believe this would assist the lead auditor in determining the appropriate level of supervision of other auditors and reduce the risk of a one-size-fits-all application of the Proposal.

Further, the Proposal acknowledges that the Board makes no distinction between an in-network and unaffiliated firm when considering the extent of supervision required by the lead auditor. We believe this lack of distinction would likely create a significant amount of additional effort and cost when in-network firms are involved, which may not be warranted in many cases and would therefore not have a commensurate benefit to audit quality. Our specific suggestions as they relate to proposed Appendix B of PCAOB Auditing Standard 2101 (currently Auditing Standard No. 9), *Audit Planning* (AS 2101) and AS 1201 are detailed in section III of this letter.

System of Quality Control

As it relates to evaluating the other auditor's compliance with independence and ethics—as well as their qualifications⁴—and in anticipation of performing certain procedures required by the Proposal, consideration of a firm's system of quality control is crucial. The Proposal does not provide for such consideration, which we believe is a critical omission. Ignoring the ability to place reliance (as appropriate) on a firm's system of quality control would cause increased effort and related cost at an engagement team level, as the burden would fall directly on each individual engagement team to meet the requirements of the Proposal. This would likely involve a duplication of effort between the lead auditor and the other auditor related to evaluating each other auditor's knowledge of the SEC and PCAOB independence and ethics requirements and technical training, among other relevant qualifications. A firm's system of quality control may vary based on legal structure and policies and procedures in place at the lead auditor firm level, and in some cases, at a global network level. Therefore, we believe it would be appropriate for the Proposal to be more clear that the lead auditor may place reliance on a firm's system of quality control, when appropriate.

Lead Auditor Determination

The determination regarding sufficiency of participation of the lead auditor in the Proposal is an important concept. We support the Board's objective that an auditor should not issue an audit opinion when the lead auditor had minimal or insufficient involvement in supervising the work performed by other auditors. There could be, however, a variety of circumstances when the determination of which firm would meet the requirements to be the lead auditor may not be possible, and which may therefore give rise to practical difficulties in applying the requirements. Examples of these circumstances are detailed in section III of this letter.

Responsibility of the Other Auditor for Their Own Work

We support the clarification in the Proposal regarding the lead auditor's responsibility for determining that adequate audit work is performed and sufficient appropriate audit evidence is obtained to support the report to be issued by the lead auditor. However, extant AS 1205.03 states that, "regardless of the principal auditor's

³ In accordance with paragraph .06 and proposed paragraph .B1 of AS1201

⁴ As required by proposed paragraph .B4 of AS2101

decision, the other auditor remains responsible for the performance of his own work and for his own report.” This statement and overall concept is not present in the Proposal. Even with additional supervisory responsibility by the lead auditor, it is our view that the other auditor, and particularly the senior engagement team members of the other auditor, should continue to bear responsibility for his/her own work and therefore we recommend that the language from extant AS 1205.03 be retained. Doing so would not diminish the overall objective of the Proposal with respect to the overall responsibility of the lead auditor, but it would serve to re-emphasize the responsibilities and expectations of the other auditor.

Further, we note that the Proposal is focused solely on the requirements of the lead auditor. We suggest that the Board consider developing a risk-based, principles-based framework for the other auditor within the Proposal to clarify and enhance the responsibilities of the other auditor in how they communicate and interact with the lead auditor. The Proposal notes that to mitigate the potential consequence that the other auditor could feel less accountable⁵, the Board proposed requiring the lead auditor to obtain from the other auditor a written report describing the other auditor’s procedures, findings, conclusions, and, if applicable, opinion. We believe that the reporting provided by the other auditor to the lead auditor plays a significant role in communicating the other auditor’s responsibilities. However, there is currently a wide divergence in practice as to when reports are provided and the form and content of such reports. We believe the Board should develop guidance on the content and format of inter-firm reports to promote consistency and help lead auditors understand the work performed and the responsibility taken by the other auditor.

III. Comments on Appendix 1 - Proposed Amendments Relating to the Performance of Audits Involving Other Auditors

Definitions

We agree with the lead auditor concept in the Proposal and support the goal of promoting consistency across the profession as to how this designation is determined and applied. However, as currently defined, individuals are part of the lead auditor only if they are employees of the registered accounting firm signing the auditor’s report. We believe this is too limiting and may result in inconsistencies in application given contemporary practices and firm structures. There are multiple scenarios where determination of the lead auditor could be problematic under the proposed definition, and those scenarios could vary based on firm and network legal structure (see Appendix for examples). We suggest the definition of lead auditor be broadened to include those engagement team members who work alongside and in the same capacity as personnel on the engagement team that are employed by the lead auditor, which is consistent with a principles-based approach to supervision.

The definition of other auditor refers to a member of the engagement team, suggesting an individual, and not just the firm. As a result of this definition, it appears the lead auditor would be required to perform certain procedures for individual members of the other auditor’s team, which may result in unnecessary effort and cost; this is further discussed in the “*Independence and Ethics*” section below.

Amendments to AS 2101

Lead Auditor Determination

We commend the Board for providing examples regarding the lead auditor’s determination of whether participation is sufficient to serve as lead auditor.⁶ Nevertheless, we believe the underlying notion of

⁵ Page 40 of the Proposal

⁶ Pages A4-15 through A4-18 of the Proposal

“participation” within the Proposal is subject to interpretation and could result in inconsistent outcomes. For example:

Example 1 - Company A is domiciled in the United States (U.S.). Most of the officers and directors are based in the U.S. However, substantially all the operations take place in Country B, including all accounting and back office functions. Further, substantially all day-to-day accounting and financial reporting decisions are made in Country B with direction from U.S.-based management. Accounting Firm X in the U.S. cannot meet the sufficiency requirement for lead auditor under the proposed amendments. However, Accounting Firm Y from Country B cannot meet the legal and accountancy requirements to issue an auditor’s report to Company A, because Accounting Firm Y cannot meet the licensing requirements in the U.S. Similarly, Accounting Firm X may not be able to perform audit procedures in Country B because of licensing or other laws and regulations governing public accounting in Country B. We believe if Accounting Firm Y is under the direct supervision of Accounting Firm X and there is sufficient supervision and review by Accounting Firm X, Accounting Firm X can issue the report as lead auditor.

Example 2 - Engagement team composition could include an engagement partner and manager (collectively Auditor X) from Firm X (located in Country A) who directly supervise engagement staff (Auditor Y) from Firm Y (located in Country B) on the audit of an issuer where the significant or higher risks of material misstatement are substantially audited by the combined team in Country B. We believe if Auditor Y are under the direct supervision of Auditor X and there is sufficient supervision and review by Auditor X, then Auditor X can issue the report as lead auditor.

The above are two examples of situations where we believe that the lead auditor may be sufficiently involved in the work performed by the other auditor such that the other auditor becomes an extension of the lead auditor and is not working independently without supervision. In these cases, the lead auditor might therefore be considered to be “participating” even though another firm is involved. In order to address scenarios such as those set forth above, it would be beneficial for the Board to further clarify what is meant by the phrase “engagement partner’s firm performs audit procedures” in AS 2101.B2.

Independence and Ethics

As currently proposed, we believe the lead auditor would be required to obtain an understanding of *each* team member’s knowledge of independence and ethics and to obtain a written representation from *each* individual engagement team member of the other auditor; which we believe would be an undue burden on the lead auditor. Obtaining this information would be complicated, and costly, especially when the other auditor is not part of the lead auditor’s network and in jurisdictions where privacy laws may impede sharing of detailed information about an individual (e.g., description of ethics learning courses taken by a staff member of the other auditor). This would also require the lead auditor to develop a process to monitor changes in the engagement team at the engagement team level of the other auditor, instead of relying on an understanding of the firm’s process and system of quality control and allowing the other auditor’s firm to monitor individual compliance. Today, these activities are performed at the firm level, with the other auditor’s engagement partner confirming to the lead auditor on behalf of the firm and team. We believe that this approach is likely more effective and more cost-efficient. If our understanding is inconsistent with the Board’s intent, we suggest that the Board clarify the requirements of AS 2101 Appendix B to reflect that the reference to other auditor is intended to refer to the other auditor’s firm or to the other auditor’s engagement team as a whole.

Amendments to AS 1201

The Proposal is unclear as to how the level of activities required by the lead auditor to supervise other auditors might vary in different circumstances. The Proposal could be interpreted as requiring the lead auditor to perform certain supervision procedures regardless of the lead auditor's understanding of the knowledge, skill and ability of other auditors who assist the engagement partner with supervision and as such, does not appear to enable the lead auditor to vary the extent of supervision of the other auditor as appropriate based on the assessed risk. We believe the proposal should clearly provide for how the lead auditor can vary the nature, timing and extent of involvement and supervision based on their understanding of the knowledge, skill and ability of other auditors who assist the engagement partner with supervision.

If the knowledge, skill and ability of the other auditor is not appropriately considered in determining the supervisory approach, the lead auditor may spend time that is unwarranted reviewing the work of a competent other auditor. This may result in less time for the lead auditor to focus on higher risk areas, which could therefore have a detrimental effect on audit quality. The PCAOB seems to acknowledge this risk on page 41 of the Proposal, which states that "because lead audit personnel would be required to perform additional supervisory responsibilities, such team members might have less time to perform other work on the same engagement. This could potentially reduce the likelihood that the auditor detects material misstatements ... and could potentially lead to inefficient allocation of audit resources."

We believe the Board should identify factors for the lead auditor to consider when evaluating the knowledge, skill, and ability of the other auditor. Factors could include: the lead auditor's knowledge of and experience working with the other auditor; the composition of the other auditor's team (such as the inclusion of a U.S. audit partner or manager on secondment); the existence of a shared or similar regulatory environment between the lead auditor and the other auditor; the results of previous audits performed by the other auditor under the lead auditor's supervision; the lead auditor firm's system of quality control as it relates to using another auditor from the same network⁷; and the other auditor's industry experience.

We acknowledge AS 1201.4 allows the engagement partner to seek assistance from appropriate engagement team members, and this appears to include partners and senior managers of the other auditors. However, Appendix B to AS 2101 and AS 1201 lists specific procedures that are required to be performed by the lead auditor, which may result in the partners and senior managers of other auditors not being sufficiently leveraged. Further, the proposed amendments do not enable the lead auditor to consider the impact of a firm's (the lead auditor firm or potentially a global network) system of quality control in determining the level of involvement of the lead auditor. Therefore, as previously noted, the lead auditor may spend unnecessary time and effort reviewing the work of a competent other auditor.

Lead Auditor Communications

The new requirement proposed in paragraph .B2a(2) of AS 1201 would require the lead auditor to communicate, in writing, tolerable misstatement, the identified risks of material misstatement and, if determined, the amount below which misstatements are clearly trivial and do not need to be accumulated relevant to the work requested to be performed. Page A4-31 of the Proposal specifies that the Board's intent is to require the lead auditor to inform the other auditors of tolerable misstatement for "the location or business unit." It would be helpful if paragraph .B2a(2) of AS 1201 specified that tolerable misstatement to be communicated is the tolerable misstatement of the location or business unit, if that is the Board's intent.

⁷ In accordance with PCAOB QC Section 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*, paragraph .06, "The system of quality control should provide the firm with reasonable assurance that the segments of the firm's engagements performed by its foreign offices or by its domestic or foreign affiliates or correspondents are performed in accordance with professional standards in the United States when such standards are applicable."

The requirement to communicate identified risks of material misstatement, rather than significant risks of material misstatement, presents a significant increase in the communications and level of work currently being performed and may not have a commensurate benefit. We believe communicating *all* risks of material misstatement is too broad. We suggest modifying the Proposal to require communication by the lead auditor of identified *significant* risks of material misstatement, as well as any other risks the auditor judges necessary, as this is more in-line with a risk-based approach.

Subject to the suggestions noted above to improve scalability and focus of the requirement, we agree having documentation of these communications through some form of written instruction would likely have a positive impact on audit quality as it would improve and clarify the communication between the lead auditor and other auditor.

Review of Other Auditor's Planned Audit Approach

The new requirement as proposed in AS 1201.B2b would require the lead auditor to obtain and review the other auditor's *description* of the nature, timing and extent of audit procedures to be performed pursuant to the scope of work described in paragraph .B2a(1). This requirement appears prescriptive and does not allow the lead auditor to take a risk-based approach. For example, the requirement could be interpreted that the lead auditor needs to obtain the entire audit program from the other auditor (i.e., including the description of *all* of the planned procedures for *all* risks of material misstatement). This would represent a significant level of effort, and one that is not likely performed today (or considered necessary) in almost all circumstances. Requiring the lead auditor to review the description of the nature, timing and extent of audit procedures in higher risk areas would be a reasonable way of retaining a risk-based approach that is scalable based on the circumstances. Further, it is not clear how detailed the description would need to be to meet this requirement. The Board should consider clarifying that a summary level description may be appropriate under certain circumstances.

Review of Specified Documentation, including Written Report

Page A4-34 of the Proposal states, "For example, the lead auditor could determine it necessary to request additional documentation for review with respect to the work performed by less experienced other auditors, or with respect to an area of heightened risk of material misstatement." A possible misinterpretation of this statement could be that regardless of which member of the other auditor team *reviewed* the work, the lead auditor should consider which member of the other auditor team *performed* the work when determining the necessary extent of its review of documentation of the other auditor's work. We believe the lead auditor should be able to leverage the review and supervision performed by the engagement partner (or sufficiently experienced team member) of the other auditor. Accordingly, the focus should be more on which member of the other auditor team reviewed the work, rather than solely who performed the work. If this is the intent of the Board, we suggest modifying the language in the Proposal to clarify that the "work performed by less experienced other auditors" would also take into account the experience of the other auditor team member reviewing the work.

Additionally, the new requirement as proposed in AS 1201.B2d would require the lead auditor to obtain a written report describing the other auditor's procedures, findings, conclusions and, if applicable, opinion. The Proposal is not clear on how detailed the written report describing procedures, findings and conclusions should be. For example, the Proposal could be read to require each step performed by the other auditor to be summarized. Similar to our comment above, we believe descriptions of procedures included in this reporting should be limited to areas of significant risks and any other risks the lead auditor judges necessary. In addition, as discussed previously, there is currently a wide divergence in practice as to when reports are provided and the form and content of such reports. We believe the Board should develop guidance on the

content and format of inter-firm reports to promote consistency and help lead auditors understand the work performed and the responsibility taken by the other auditor.

Multi-tier Audits

Providing for the first other auditor to support the lead auditor in supervisory responsibilities over the second other auditor⁸ is a reasonable approach in the Proposal. However, the Proposal states the lead auditor remains responsible for informing directly both the first other auditor and the second other auditor of the matters in paragraph .B2a of AS 1201. This is generally a greater degree of work than is currently performed in practice, where, for example, the lead auditor may communicate scope, tolerable misstatement, and identified higher risks to the first other auditor with supervisory responsibility (e.g., a regional coordinating team)—this first other auditor then directly communicates with the second other auditor and reviews the second other auditor’s work and related deliverable. The Proposal may therefore lead to increased cost and reduced audit quality. The first other auditor may have a closer proximity and greater understanding of the second other auditor (e.g., they may have the most knowledge about the regional business environment) compared to the lead auditor, and therefore be better positioned to communicate and supervise directly with the second other auditor. There is a risk that the supervisory activities of the first other auditor would be overlooked or discounted (to the detriment of audit quality), given the proposed requirement for the lead auditor to communicate directly with all other auditors.

Often the most effective approach to identifying and assessing risks of material misstatement in an audit is to develop the audit plan considering the manner in which the issuer manages its financial reporting. In a multi-tier structure, there can be very important processes and controls that occur at a regional level before “rolling up” to consolidated totals. By requiring the lead auditor to communicate directly with the second other auditor, the first other auditor may have a reduced or nonexistent role in important communications. The first other auditor may have a unique understanding of how the information from the other entities within that region aggregate into the regional totals, such that audit quality would be diminished if the lead auditor were not permitted to delegate the requirement to directly inform the second other auditor of the matters in proposed paragraph .B2a to the first other auditor. Although the lead auditor is allowed to delegate supervision of the second other auditor to the first other auditor, we are concerned this supervision will be less effective if the first other auditor’s role in directly communicating with the second other auditor is reduced or eliminated.

Amendments to Auditing Standard 1215 (currently Auditing Standard No. 3), *Audit Documentation* (AS 1215)

Proposed paragraph .19A of AS 1215 would add a requirement for the lead auditor to document a “list of additional work papers of other auditors (beyond those described in paragraph .19) that were reviewed by the lead auditor, but not retained by the lead auditor, if any. The list must include a description of the work papers reviewed, the reviewer, and the date of such review.” We believe the requirement to include a description of the work papers reviewed is unnecessary and would result in additional effort and cost that does not enhance audit quality. If based on risk, the lead auditor determines the need to review work papers we would propose a list that includes the work paper title and reference number or audit step name would be clear as to which work papers/audit steps were reviewed. Given the requirements of the other auditor to retain the work papers, the listing of work papers reviewed by the lead auditor, if any, would meet the performance standard of extant AS 1215.

We agree with the Board’s proposal not to require the lead auditor to list all documents in the other auditor’s files, including those not reviewed by the lead auditor.

⁸ Page A1-24, paragraph B3

IV. **Comments on Appendix 2 - Proposed AS 1206: Dividing Responsibility for the Audit with Another Accounting Firm**

We appreciate the Board's approach in drafting the separate standard related to dividing responsibility in an audit. We are supportive of the definition of referred-to auditor. By separating it from the "other auditor" term, greater clarity is provided as to both referred-to auditors and other auditors and how the auditing standards apply to each. We are concerned, however, about how the notion of lead auditor intersects with the Securities and Exchange Commission's (SEC) use of "principal accountant" in situations where responsibility is divided and believe clarity around how the PCAOB's terms align with the SEC's terms would be useful.

We also note certain instances where extant language was not carried over into Proposed Auditing Standard 1206: *Dividing Responsibility for the Audit with Another Accounting Firm* (Proposed AS 1206). We are concerned this may cause unintended changes from current practice. Since the Proposal only addresses the requirements when making reference to another auditor, the guidance in extant AS 1205.05-.06 on whether to make reference has been superseded. Under the extant standard, a firm generally does not make reference to another firm in its global network. We believe the omission of such guidance in the Proposal could indicate that such considerations are no longer appropriate, which might result in a change in practice. The profession will continue to face scenarios where it may be impractical for the lead auditor to take responsibility for other auditors' work. We believe the decision-making around whether to make reference to another accounting firm is critical and should be included either in Proposed AS 1206 or in AS 2101.

Further, the Proposal does not allow for division of responsibility when the financial reporting frameworks are different.⁹ This would create a change in practice since existing standards¹⁰ allow for such division under certain conditions, as well as current practice as allowed and described by the SEC's non-authoritative *Financial Reporting Manual*¹¹. We are concerned the Proposal may cause issues for both large and small firms. As an example, a foreign subsidiary's financial statements prepared in accordance with IFRS may be audited by another accounting firm and the consolidated financial statements are prepared in accordance with U.S. GAAP. In current practice, the principal auditor may make reference to the other auditor's report after (i) determining the measurement, recognition, presentation and disclosure criteria applicable to all material items in the subsidiary's financial statements under IFRS are similar to the criteria applicable to all material items in the consolidated financial statements; and (ii) evaluating the appropriateness of adjustments to convert the subsidiary's financial statements to U.S. GAAP. We believe this is an important option that should be afforded to auditors under PCAOB auditing standards in order to align the PCAOB's requirements with those of the SEC. We therefore encourage the PCAOB to incorporate the corresponding requirements into proposed AS 1206.

Finally, in the current international environment where mandatory firm rotation has been or is in the process of being adopted in many jurisdictions, the number of instances when the lead auditor will refer to another auditor outside the lead auditor's global network may increase significantly; therefore, the ability to divide responsibility is an important concept that should be retained.

⁹ Proposed AS 1206.06, "The lead auditor may divide responsibility for the audit with another accounting form only if:
(b) The financial statements of the company's business unit audited by the referred-to auditor were prepared using the same financial reporting framework as the financial reporting framework used to prepare the company's financial statements.

¹⁰ Statement on Auditing Standards No. 127, *Omnibus Statement on Auditing Standards-2013*

¹¹ SEC Division of Corporation Finance Financial Reporting Manual, section 6820.07

V. Other Comments

We agree with the comments set forth in the Proposal that the proposed amendments could benefit audits of emerging growth companies (EGCs) and brokers and dealers that are required to be conducted in accordance with PCAOB standards. Accordingly, we support applicability of the Proposal to those entities.

The CAQ appreciates the opportunity to comment on the Proposal and would be pleased to discuss our comments or answer any questions that the Board may have regarding the views expressed in this letter.

Sincerely,



Cynthia M. Fornelli
Executive Director
Center for Audit Quality

cc:

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Appendix – Definition of Lead Auditor

The following are examples where we believe the individual working alongside and in the same capacity as personnel on the engagement team that are employed by the lead auditor should be considered part of the lead audit team. Under the Proposal, it appears the individual would be another auditor due to their employment status with a firm other than the firm issuing the report.

1. Short-term Personnel Sharing Arrangements and Contract Employees

For many firms, short-term (e.g., less than six months) personnel employment arrangements exist, such as personnel sent from a foreign office to a U.S. office or individuals contracted for hire from temporary workforce agencies. These individuals often retain employment status with the foreign office or temporary workforce agency. As the Proposal is currently written, such an individual would be part of the other auditor. If the individual gave up their employment with the foreign firm or temporary workforce agency and was hired, on a short-term basis, by the U.S. firm, the Proposal would indicate that this individual would be part of the lead auditor. Therefore, depending on the structure of the employment arrangement, there may be different outcomes. We believe that the individual should be considered part of the lead auditor when they are working in the same capacity as personnel employed by the lead auditor. If, in order for the individual to be considered part of the lead auditor, there was a need to change employer, there would likely be a significant incremental cost to this arrangement with no parallel enhancement in audit quality.

2. Talent Deployment Strategies

Firms are evolving in the manner in which they deliver audit services. Some firms utilize global talent deployment strategies whereby certain portions of the audit are performed by individuals that may be located in a country different than the country of the lead auditor (such individuals may or may not be in an accounting firm and may or may not be part of the same registered firm). These individuals may operate as extended members of the lead auditor, not as a separate component team. We believe that in such cases the employee should be considered part of the lead auditor assuming they are working as part of the lead auditor team. However, similar to short-term personnel sharing arrangements as noted above, the legal employment of the individual could vary by firm and impact whether the individual is considered part of the lead auditor or other auditor.



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July 29, 2016

Office of the Secretary
 Public Company Accounting Oversight Board
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Re: PCAOB Rulemaking Docket Matter No. 042,
*Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and
 Proposed Audit Standard – Dividing Responsibility for the Audit with Another Accounting Firm*

Dear Office of the Secretary:

Crowe Horwath LLP appreciates the opportunity to comment on the Public Company Accounting Oversight Board's Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and the Proposed Audit Standard – *Dividing Responsibility for the Audit with Another Accounting Firm* (Proposed Amendments or Proposed Standard, as applicable).

We support the Board's effort to improve audit quality by enhancing an existing standard that has been part of audit standards since the 1970's. We also agree with the Board's decision to provide a new specific standard for when the auditor divides responsibility for an audit with another accounting firm. We are pleased to provide our observations regarding areas where we believe the Proposed Amendments or the Proposed Standard could be modified to provide clarity for the auditor as well as observations related to risk based concepts.

Our observations are cross referenced to specific paragraph language within the Proposed Amendments or Proposed Standard as well as specific questions, where relevant.

Proposed Amendments

Sufficiency of Lead Auditor Concept

We have general concern over the term "participation" of an auditor in determining if there is sufficient participation to be the lead auditor. Our concern is based on existing risk based standards when combined with the proposed amendments as noted below.

Page A1-14, paragraph B2 (AS 2101) under "Serving as the Lead Auditor in an Audit that Involves Other Auditors or Referred-to Auditors", notes "*In an audit that involves other auditors or referred-to auditor, 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 risks of material misstatement associated with the portion of the company's financial statements for which the engagement partner's firm perform audit procedures (which includes considering the portion's materiality), in comparison with the portions for which the other auditors perform audit procedures or the portions audited by the referred-to auditor.*"

As noted in paragraph B2, the Proposed Standard would revise the requirement to determine the sufficiency of participation, by requiring the determination to be based on the risks of material misstatements associated with the portions of the financial statement audited by the engagement partner's firm relative to the portion audited by other auditors. The Proposed Standard indicates that imposing this determination, will increase the likelihood that the firm issuing the auditor's report actually performs audit procedures for a meaningful portion of the company's financial statements. The engagement partner firm (lead auditor) is defined at paragraph A4, on page A1-13 based on proposed standards and does not include a firm within the network of the engagement partner firm, nor does this definition of lead auditor appear to include any auditor not employed by the lead auditor firm but who could be directly supervised by the lead auditor. We agree that the participation of the lead auditor should be meaningful. However, we believe under either a direct supervision model or a direct assistance model the lead auditor should include that activity in their determination of meaningful participation. We discuss more on the concepts of direct supervision and direct assistance below.

Currently AS 2110, paragraph 68 notes that there is a presumption of fraud risk involving improper revenue recognition, thus the auditor should presume this fraud risk and evaluate which types of revenue, revenue transactions, or assertions may give rise to such risks. Paragraph 70b of this standard also indicates that all fraud risks are significant risks.

The above point regarding sufficiency of participation (paragraph B2) was then illustrated in a couple of examples on pages A4-15 through 18. Example 2 notes that revenue in the other countries represents routine sales and operating activities, which involve no significant accounting judgments. Those activities have not significantly changed over the past several years. Based on this factor, and the fact that Accounting Firm 1 in the example performed procedures at the location that prepared the financial statements, made significant accounting judgments, and handled the complex accounting issues, than Accounting Firm 1's participation was sufficient to be the lead auditor. However, the example also notes that if the other locations had more complex operations with higher risk of material misstatements, Accounting Firm 1 would likely need to directly audit more locations.

Regarding the above example, we have concerns as it relates to revenue in multi-location or multi-national companies. The example appears to identify revenue recognition in the other countries as not a significant risk and therefore the other risk factors noted outweigh revenue risk. This appears to be inconsistent with the concept in AS 2110 that indicates revenue recognition is a significant risk. Therefore, we recommend the PCAOB consider whether AS 2110 should be amended to reflect this conceptual change noted in the example. We also understand the determination of sufficient participation requires judgment and cannot be defined by a formula, however, including an example where sufficient participation is determined when the only risk of material misstatement was revenue recognition would be helpful. Overall, we believe the examples presented help the auditor to form an opinion based on the proposed amendments. However, based on our observations above, we would encourage the PCAOB to clarify and or provide additional examples to help auditors understand what the PCAOB considers sufficient participation. This observation relates to Question 21.

Based on reading the examples in the Proposed Standard, it appears that the review by the lead auditor of testing performed by another auditor is not considered "participation". We believe use of other auditors, when responsibility is not divided and the lead auditor reviews the detailed work papers, should qualify as "participation" by the lead auditor. For example: the lead auditor plans the work, understands the risks and has elected to utilize another auditor to execute the plan. The lead auditor is taking responsibility for that work performed, has reviewed the detailed work and as a result is responsible for the audit quality of that work performed. We believe that level of understanding and involvement by the lead auditor should be sufficient for them to include that portion of the audit as part of what the lead auditor performed in concluding on level of participation.

As drafted in the Proposed Amendments, there does not appear to be a concept of direct assistance. In addition, the Proposed Standard simply addresses other auditors in which responsibility will be divided. However, under the Proposed Amendments, we believe a concept of direct assistance could be added. This concept would cover situations in which the lead auditor engages another auditor to perform certain procedures, but the lead auditor directly supervises, reviews and evaluates the detailed work performed as if the other auditor was an extension of the lead auditor. We believe this is a different level of supervision than what is noted in the proposed amendments to AS 1201, paragraph B2c (page A1-23). We also believe this should allow the lead auditor to include this participation in their overall assessment of the sufficiency of their involvement to be lead auditor.

Reporting by Other Auditors

In supervising the work of other auditors, the lead auditor should obtain from the other auditor a written report describing the other auditor's procedures, findings, conclusions, and if applicable, opinion (AS 1201, page A1-23, par B2d). As noted by the PCAOB, in many situations reporting similar to this description takes place today in practice. We agree with that statement, however, this reporting is unstructured and thus takes on many different forms and content today. Considering the PCAOB is proposing this reporting as a requirement, we believe that the profession would benefit from suggested examples as part of these Proposed Amendments. In addition, the requirement simply states "procedures, findings, conclusions, and, if applicable, opinion". This could be interpreted to indicate a list of all procedures and all findings which does not seem appropriate. From a conceptual perspective, we believe the profession could benefit from additional clarification of what the PCAOB believes is appropriate, such as procedures and findings related to significant risk areas.

Question 33 asks several questions related to the reporting by other auditors. As noted above, we believe several suggested examples could help firms in meeting this requirement and ensure appropriate items are addressed, as expected by PCAOB. Additionally, this requirement likely results in a change in practice for all firms, since current content of reports may not meet PCAOB requirements or expectations.

Finally, we believe the PCAOB should exclude other auditors performing work under a direct supervision model or a direct assistance model from AS 1201, paragraphs B2(b, c, d and e). As noted above, we believe under either a direct supervision model or direct assistance model, there should not be a requirement for reporting since the other auditors would be considered part of the lead auditor firm and the other auditor work is typically incorporated directly within the lead auditor work papers. If the standard was adopted as currently drafted, it is likely that additional time and effort will be spent by all firms under the proposed amendments in order to ensure reporting covers the various content points in paragraph B2d, which will add additional cost to the audit without a perception of benefit.

Other Auditors – Letters of Representation

As proposed in AS 1215, paragraph 19 (page A1-26 and 27) – "*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 offices of the firm and other auditors*". The documentation noted includes letters of representations from management as item "g". Currently, AS 2805 addresses management representations, but this guidance is based on representations from management as part of an audit of financial statements. In many situations the use of other auditors may not be for an audit of a complete set of financial statements. Other auditors may be used for specific testing of certain elements of the financial statements and the timing may or may not coincide with the completion date of the overall financial statements and the opinion date. As a result of these items we believe the PCAOB could provide clarity associated with the following matters:

- a. Should the letter of representation be required in all cases, or only if there is an audit of financial statements performed by other auditors?
- b. Should you obtain a letter of representation if other auditors only perform limited procedures, such as a revenue test?
- c. What should be the date on the letter of representation – for example, the report release date at the subsidiary level or the report release date at the parent company level?
- d. What are the requirements to update a letter of representation obtained prior to the parent company report release date?

We suggest that item “g” be moved to a recommended matter based on the risk associated with the procedures performed by another auditor as well as the level of knowledge that corporate management signing the overall letter of representation has of the various other operations. We believe by making this a recommended step, the PCAOB could be less prescriptive in their guidance and allow the auditors to use their judgment on the letter of representation wording as well as dating to address the associated risk.

Investment Accounted for Under the Equity Method

As proposed under AS 2503, par 28 (page A3-20) the auditor should obtain sufficient evidence in support of the investee’s financial results for valuations that are based on an investee’s financial results, including the equity method of accounting. *“In determining whether or not the report of 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 of the investee’s auditor, visiting the investee’s auditor and discussing the audit procedures followed and the results thereof, and reviewing the auditor program and/or working papers of the investee’s auditor.”* Considering the nature of an investment, the sufficiency of the audit evidence may be based on an audit performed under PCAOB, AICPA, International or a specific other country audit standards since the owners of these investments do not control the related entity, therefore the owner cannot require an audit in accordance with PCAOB audit standards to be performed. As noted in AS 1105, sufficiency of evidence is based on quantity of evidence which is affected by risk of material misstatement and quality of audit evidence. We believe providing clarity to paragraph 28, including when the PCAOB believes an opinion using PCAOB audit standards would be preferred or suggested would be beneficial.

Using a Service Auditor’s Report

The Proposed Amendments (AS 2601, par 19) appear to have changed the requirements of the following three procedures from *“should give consideration to the guidance”* to *“In considering whether the service auditor’s report is sufficient to meet his or her objectives, the user auditor should consider performing one or more of the following”* procedures (listed as bullet points). The three procedures noted as bullet points are: 1) visiting the service auditor and discussing the audit procedures followed and results thereof, 2) reviewing the audit programs of the service auditor. In some cases, it may be appropriate to issue instructions to the service auditor as to the scope of the audit work, and 3) reviewing additional audit documentation of the service auditor. While these items are noted as “consider” the paragraph under these bullet points indicates additional procedures to perform if the user auditor believes the service auditor’s report is not sufficient. This language may lead an auditor to presume that at least one of the three steps noted is more than “consider” in order to document the sufficiency of the report. Also, if the auditor believes the service auditor’s report may not be sufficient, it is suggest that the auditor may supplement their understanding “by discussing with the service auditor the scope and results of the service auditor’s work”. This procedure appears to be very similar (potentially redundant) to procedure number 1 above (first bullet point in the proposed standard) however not as extensive, which does not appear appropriate based on the circumstance. As a result, we believe the three bullet points to consider are better positioned as a response for the user auditor to take when the service auditor’s report may not be sufficient.

Crowe Horwath LLP supports the PCAOB’s efforts to improve public company auditing standards and the due process to ensure proposed standards result in such improvement, mindful of cost benefit considerations and avoidance of unintended consequences. We would be pleased to respond to any questions regarding our observations noted within this letter. This is a complex subject and if there are any other questions regarding this subject, please contact Michael G. Yates at (574) 236-7644.

Sincerely,

Crowe Horwath LLP

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July 28, 2016

Office of the Secretary
 Public Company Accounting Oversight Board 1666 K Street, N.W.
 Washington, D.C. 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 042

Deloitte & Touche LLP (“D&T” or “we”) is pleased to respond to the request for comments from the Public Company Accounting Oversight Board (the “PCAOB” or the “Board”) on its *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors* (the “Proposed Amendments”) and the *Proposed Auditing Standard — Dividing Responsibility for the Audit with Another Accounting Firm* (the “Proposed Auditing Standard”) (collectively, “the Proposal” or “the Release”) which addresses potential changes to the PCAOB’s auditing standards for audits that involve accounting firms and individual accountants outside the accounting firm that issues the audit report.

OVERALL COMMENTS

We support the Board’s efforts to enhance the standards of the PCAOB that address audits involving accounting firms and individual accountants outside the accounting firm that issues the auditor’s report and to align the applicable requirements with the PCAOB’s risk-based standards.

The Proposal represents a significant step forward in providing a risk-based supervisory model that can be used when performing audits that involve other auditors. We are supportive of the objectives of the Board’s Proposal, and offer certain constructive suggestions in this letter that are geared toward ensuring that the final standards clarify the lead auditor’s responsibilities with respect to other auditors, including providing additional direction to the lead auditor on how to apply the principles-based supervisory requirements of the standards in order to:

- Increase the uniformity, consistency, and effectiveness of the lead auditor’s supervision of other auditors, including through application of PCAOB Auditing Standard 1201, *Supervision of the Audit Engagement* (AS 1201), to other auditors.
- Facilitate improvements in the quality of the work of other auditors through appropriate direction, coordination, and evaluation of the results of their work.
- Strengthen the lead auditor’s understanding of the knowledge, education, and skills of those engagement team members from an other auditor who participate in supervisory activities.
- Enable the lead auditor to delegate certain supervisory activities to appropriate other auditors outside of the lead auditor’s registered accounting firm.
- Clarify the substance of the interactions between the lead auditor and other auditors.

In order to clearly achieve the objectives above, there are certain practical implementation considerations that will need to be deliberated and resolved. The potential benefits of the Proposal are significant and, while some of these considerations are complex and challenging, we do not believe any of these should stand in the way of completing this important project. We stand ready to engage constructively with the Board and other stakeholders to provide our perspective and experiences in order to facilitate the development of improvements to the PCAOB’s auditing standards that will enhance audit quality. A brief summary of the primary matters for additional consideration that we have identified is as follows (we offer further thoughts on each in Appendix 1):

Definition, Roles, and Responsibilities of the Lead Auditor, Including Sufficiency of Participation.

We believe that the appropriate oversight of other auditors is achieved through a combination of the lead auditor's direct participation in the audit as well as other factors, such as sufficient involvement in, and supervision of, the work of other auditors. We therefore offer recommendations to achieve this goal through modifications to the definition of lead auditor. We also offer thoughts on developing requirements and guidance that provide necessary levels of scalability arising from the continuing evolution of (1) the way in which financial information and reporting is organized, processed, and recorded by complex, multi-national entities and (2) the manner in which accounting firms (and their networks) are organizing themselves, structuring their engagement teams, and innovating audit execution techniques.

Determining the Other Auditor's Compliance with Independence and Ethics Requirements. Our recommendations support the goal of a risk-based approach that acknowledges the ability to rely on an effective shared system of quality control at the network level.

Dividing Responsibility for the Audit with Another Accounting Firm. We fully support the continued practice of enabling registered accounting firms to make reference to the audit of an other auditor in the auditor's report. Our observations and recommendations serve to preserve and enhance a long-standing and necessary practice.

We offer further observations on other areas of the Proposal in Appendix 2 related to the auditor's performance requirements, as well as editorial comments in Appendix 3.

We commend the PCAOB Staff for devoting a significant portion of the May 18, 2016, Standing Advisory Group meeting ("SAG Meeting") to discussing matters relevant to the Proposal and hearing input from a variety of stakeholders. Furthermore, we recommend that the Board perform outreach with the International Auditing and Assurance Standards Board (IAASB), which has recently issued an Invitation to Comment, *Enhancing Audit Quality in the Public Interest — A Focus on Professional Skepticism, Quality Control and Group Audits* (the ITC), which includes a number of proposed actions to enhance the IAASB's standards related to quality control and group audits. As the Proposal has noted, many public accounting firms have based their methodologies on the IAASB's standards. The information obtained from the ITC (including identification of challenges that auditors face) and the comments from respondents may be useful to the PCAOB as it continues with its standard-setting activities. Similarly, the IAASB may also benefit from the perspectives of the PCAOB and views of commenters to the PCAOB's Proposal. Therefore, we encourage the PCAOB to engage constructively with the IAASB on this project.

* * *

D&T appreciates the opportunity to provide our perspectives on these important topics. Our comments are intended to assist the PCAOB in analyzing the relevant issues and potential effects of the Proposal. We stand ready to collaborate with the PCAOB on these important matters. If you have any questions or would like to discuss these issues further, please contact Dave Sullivan at 714-436-7788 or Megan Zietsman at 203-761-3142.

Very truly yours,



Deloitte & Touche LLP

cc: James R. Doty, PCAOB Chairman
Lewis H. Ferguson, PCAOB Member
Jeannette M. Franzel, PCAOB Member
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Kara M. Stein, SEC Commissioner
Michael S. Piwowar, SEC Commissioner
James V. Schnurr, SEC Chief Accountant
Wesley R. Bricker, Interim Chief Accountant
Brian T. Croteau, SEC Deputy Chief Accountant
Russell G. Golden, FASB Chairman

APPENDIX 1

Definition, Roles, and Responsibilities of the Lead Auditor, Including Sufficiency of Participation

As articulated in the “Overall Comments” section of this letter, we recognize and support the Board’s objectives and believe that sufficient oversight and involvement by the lead auditor in an audit that involves other accounting firms is critical to audit quality. We fully support strengthening requirements in the PCAOB’s standards in this area. As noted in the Release, many accounting firms and networks, including the Deloitte network, have adopted requirements and guidance beyond the current requirements of PCAOB Auditing Standard 1205, Part of the Audit Performed by Other Independent Auditors. We believe embedding leading practices into the standards of the PCAOB is appropriate and will be beneficial to audit quality.

We believe that effective oversight of other auditors is achieved through a combination of the lead auditor’s direct participation in the audit as well as other factors such as sufficient involvement in, and supervision of, the work of other auditors. As currently drafted, we believe the Proposal could be improved by:

- Defining lead auditor more broadly by enabling individuals from more than one registered accounting firm to perform certain supervisory audit activities and procedures in a multi-national audit when those activities and procedures may be better executed by other auditors who belong to a different accounting firm.
- Applying multiple criteria to demonstrate sufficient involvement as lead auditor, rather than having direct participation as the predominant criteria.
- Clearly enabling the lead auditor to follow a scalable, risk-based approach to determine the nature and extent of the necessary supervision of, and involvement with, other auditors.
- Recognizing that global networks may have established a shared system of quality control (i.e., network-level policies, processes, and controls) that, when operating effectively and monitored appropriately, should influence how the lead auditor achieves the requirements of the PCAOB’s standards.

As currently drafted, there may be circumstances, based on the structure of the company being audited and the nature of its cross-border operations and financial reporting, where it will be difficult to identify a registered public accounting firm to serve as the lead auditor.

Lead Auditor — Definition. The definition of lead auditor (PCAOB Auditing Standard 2101, *Audit Planning* (AS 2101)). Paragraph A4(b) appears to preclude other auditors from fulfilling certain planning and supervisory roles and responsibilities designated in the Proposal, as such requirements are for the lead auditor to fulfill. At the same time, AS 1201 allows other auditors, as members of the engagement team (AS 2101.A3(a)), to assist the engagement partner in fulfilling the engagement partner’s supervisory responsibilities identified in AS 1201. We believe this dichotomy may create confusion as to which supervisory activities the other auditor may or may not perform.

In addition, we believe that certain requirements assigned to the lead auditor may better be performed by an other auditor that is more familiar with the language, culture, business environment, and laws and regulations of the business unit or location (and is near the business unit or location).

- For example, we do not believe that in all cases the lead auditor would be in the best position to execute the requirements to gain an understanding of each [individual] other auditor’s “knowledge of the SEC and PCAOB independence requirements and their

experience in applying those requirements” (AS 2101.B4(a); see further comment in Independence section below). These procedures may be better performed either solely by the other auditor, or in combination with the lead auditor, as opposed to solely by the lead auditor.

- For example, in a diversified company, identifying and assessing the risks of material misstatement at individual locations or business units where an other auditor is being used is an activity that is best performed with involvement by both the lead auditor and the other auditor. Similarly, in a situation of a newly acquired subsidiary in an other auditor’s jurisdiction, the other auditor may have much greater knowledge and understanding of the location and the risks of material misstatement that the subsidiary may pose to the consolidated financial statements than the lead auditor.

Another challenge with respect to the proposed definition of lead auditor being limited to a single registered accounting firm is that in certain cases, the engagement partner’s team may be part of a different legal entity than the engagement partner. This may be due to local laws or regulations, such as those that require a separate accounting firm to be established within individual states or provinces within a country. Furthermore, the linkage of lead auditor to a registered accounting firm is not consistent with current practice or the existing ability under AS 1201 to allow individuals from different firms to assist the engagement partner with their AS 1201 supervisory responsibilities. We believe audit quality is best served by ensuring that the appropriate engagement team is in place, without undue emphasis being placed on the legal entities in which these resources reside.

We believe the clearest approach would be to define lead auditor as “the engagement partner, the engagement partner’s team, and designated individuals from other auditors who are performing planning and supervisory activities.” This would eliminate the categorical relationship of the lead auditor to a single registered accounting firm. An expanded definition also would enable the engagement partner to identify, using judgment and based on their knowledge and experience and on the facts and circumstances of the company and its operations, those members of the engagement team who are best suited to directing and supervising the identification, assessment, design, and performance of procedures to respond to risks of material misstatement, in addition to assessing considerations related to ethics and independence. This is of particular importance in a multi-tiered structure (i.e., where an other auditor is supervising the work of a second other auditor; for example, where there is a sub-consolidation of financial information in a region).

Sufficiency of Participation as Predominant Lead Auditor Criterion. The Proposal provides limited criteria for determining the lead auditor; specifically, the only criterion described in the Proposal is 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. We are concerned that this one data point, coupled with the narrow definition of lead auditor discussed above, will create a challenge in identifying who may serve as lead auditor. This challenge could be partially mitigated if the changes to the definition and responsibilities of lead auditor that we have suggested above are reflected in the final amendments to the PCAOB’s standards. Otherwise, we have concerns that focusing only on the quantitative metric of “coverage” of performing audit procedures that address risks may result in the inability for any registered accounting firm to meet the lead auditor definition and requirements to serve as such.

- For example, a company’s operations are spread across business units/locations in 50 global jurisdictions where each location contains two percent of consolidated totals. In that case, in order to execute the audit, dozens of accounting firms will likely have to participate in the audit (e.g., due to local licensing and other laws and regulations that preclude accounting firms performing work in jurisdictions where they are not licensed).

- The engagement partner's firm may be selected based on factors such as the domicile of the company, its key decision makers, and the location of its consolidation activities and majority of shareholders. But that same firm may only directly audit small percentages of consolidated account balances. It is unclear whether in such a circumstance, under the Proposal, the engagement partner's firm (which is also the registered accounting firm) would meet the requirements of being the lead auditor.
- For example, a company may process most of its financial reporting transactions in one or more shared service centers located in jurisdictions outside the jurisdiction where the company is domiciled. Other accounting firms may perform the audit work at these shared service centers. Similar to the preceding example, the registered accounting firm in the jurisdiction where the company is domiciled may only directly audit a small portion of the consolidated financial statements. It is unclear whether in such a circumstance, under the Proposal, the registered accounting firm in the jurisdiction of the company's domicile could meet the requirements of being the lead auditor.
 - For example, a company considered a foreign private issuer because of the requirements of the Securities and Exchange Commission (SEC) (including the domicile of the majority of its shareholders) may have the majority of its key decision makers and operations in a different jurisdiction than where the company is domiciled. The registered accounting firm in the jurisdiction of the company's domicile may not, based on licensing laws or regulations, be able to perform procedures in the jurisdiction where the majority of operations exist. It is unclear whether in such a circumstance, under the Proposal, the registered accounting firm in the jurisdiction of the company's domicile could meet the requirements of being the lead auditor.

We believe that there are multiple criteria that should be considered in determining which registered accounting firm can and should act as the lead auditor, beyond just the consideration of the risks of material misstatement associated with the portion of the company's financial statements audited by the engagement partner's firm relative to the portion audited by other auditors. These criteria should include not only factors related to the company (e.g., the legal domicile of the company, the location of the company books and records, the location of the company's executives and key decision makers) but also factors related to the auditor and audit (e.g., professional licensing requirements; the lead auditor's involvement with the other auditors; knowledge of, and experience with, the other auditor; the nature of the business unit or location audited by the other auditor; the business environment and culture in which the other auditor operates).

We believe these additional criteria would be helpful in identifying the lead auditor and in developing a risk-based framework for supervision of other auditors by the lead auditor and engagement team. If a shared system of quality control at the network level exists and is operating effectively, we believe reliance by the lead auditor on such commonalities should influence the nature, timing, and extent of direction and supervision of other auditors from the same network. A shared system of quality control, when operating effectively, provides shared methodologies and a common "language" and understanding that is distinct from other auditors outside of the network. We believe the standard should recognize this distinction as part of its risk-based, scalable approach to direction and supervision.

We believe the requirements in AS 2101.B2 should also be expanded to include the following considerations:

- **The involvement of the lead auditor.** We believe that in-depth involvement of the lead auditor in the audit (including the work performed by other auditors) is the most significant factor in determining that a quality audit will occur. The necessary level of lead auditor involvement in work performed by other auditors should be based on the factors in AS

2101.12, as well as on the lead auditor's assessment of the competence and expertise of the other auditors. For example, if an other auditor is performing audit procedures at a location with a relatively small percentage of the consolidated totals, but the location operates in an unstable economic environment and its financial information gives rise to significant or higher risks of material misstatement, we believe that it would be imperative that the lead auditor be meaningfully involved in the work performed by this other auditor.

- **The factors in AS 2101.12.** AS 2101.12 identifies factors that are relevant to the identification and assessment of risks of material misstatement associated with a location or business unit. In addition to these factors being important to identifying risks of material misstatement, they also provide relevant considerations for determining the necessary level of involvement by the lead auditor in the other auditor's work. For example, consider the scenario where the financial information at a business unit does not have any significant risks, the systems are highly centralized and automated, there is no history of errors, and the other auditors are competent and experienced. Even if the materiality of the business unit is significant in comparison to the consolidated entity, the lead auditor may determine that the necessary level of direct involvement in the work performed by the other auditor may be less extensive than locations with higher risks of material misstatement.
- **The competence and experience of the other auditor.** Understanding the knowledge, education, and skills of the other auditor is a critical factor in determining how involved the lead auditor needs to be in the work of the other auditor. Information such as past inspections results, the experience and knowledge of the other auditor (including whether the other auditor is part of the lead auditor's network), and the lead auditor's interactions with the other auditor all contribute to the lead auditor's determination as to whether the other auditor is capable of performing the requested work. Determination of the competence and experience of the other auditor will influence the lead auditor's involvement with the auditor:
 - For example, if the lead auditor determines that even though an other auditor has received appropriate training and appears sufficiently skilled, they have little experience performing audit procedures in the areas where the lead auditor is asking them to perform procedures, the lead auditor may determine it appropriate to be more heavily involved in the direction and supervision of the other auditor's work.
 - For example, if the lead auditor has extensive experience working with the other auditor, has first-hand knowledge of their skills, and has determined that the other auditor is capable of assisting the lead auditor with supervisory activities, the lead auditor may determine that the necessary level of involvement in the other auditor's work does not need to be as extensive as in the previous example.
- **The nature, timing, and extent of communication with the other auditor.**
 - We believe that ongoing two-way communication between those auditors who are responsible for supervisory activities (whether engagement partner, other members of the lead auditor's team, or other auditors) and other engagement team members underpins the performance of a quality audit and is therefore essential. Accordingly, we are supportive of enhancements to the PCAOB's standards that will drive appropriate and effective two-way communication. We also believe that it is the engagement partner's responsibility to determine that the appropriate individuals are involved in the supervisory activities of an audit. The appropriate nature, timing, and extent of communication between auditors should be risk-based and scalable, and therefore should be a function of many factors, including:
 - The experience the lead auditor has with working with the other auditor and the resulting understanding of their knowledge, education, and skills.

- The results of PCAOB inspections, internal practice reviews (if within the same network), other inspection results, and their relevance to the other auditor’s work.
- The complexity and nature of judgments related to the procedures that the lead auditor has requested the other auditor to perform, including whether the other auditor is responsible for performing procedures related to significant risks.
- If in place and effective, a shared system of quality control for network firms.
- The business and cultural environment in which the other auditor operates.
- The factors described in current AS 1201.6.

We therefore recommend that AS 2101.B2 be modified to give appropriate recognition to qualitative factors that are critical in determining the sufficiency of the lead auditor’s participation in the audit.

Audit Documentation. Accounting firms continue to evolve and innovate in terms of organizational structure, engagement team composition, and audit execution techniques. This means that:

- Engagement team members may not all be from the same office (even when they are from the same firm).
- Some engagement team members may work remotely some, most, or all of the time.
- Audit tools and techniques are becoming more data-driven.
- Audit documentation and retention methods are increasingly paperless and virtual, in keeping with similar changes in company record retention.

Challenges with respect to access to audit documentation prepared by other auditors and audit documentation retention continue to exist, and are for the most part driven by jurisdictional laws and regulations, including privacy and confidentiality. As more jurisdictions implement mandatory firm rotation, the use of firms unaffiliated with the engagement partner’s firm will likely increase, which will increase the challenges related to access to audit documentation. It is important that the PCAOB’s auditing standards are able to be operationalized in an environment in which work structures and the nature of audit evidence will continue to change.

PCAOB Auditing Standard 1215, *Audit Documentation* (AS 1215), requires that “[t]he 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 [AS 1215] is prepared and retained. Audit documentation supporting the work performed by other offices of the firm and other auditors must be retained by or be accessible to the office issuing the auditor’s report” (AS 1215.18). The following identifies certain concerns that we have regarding changes to the PCAOB’s standards related to audit documentation, and our suggested recommendations:

- We believe AS 1215.19A is overly focused on the “office issuing the report.” We agree that it is reasonable to expect that a list of the work papers reviewed by the lead auditor or other auditors assisting the lead auditor be maintained; however, requiring this list to be maintained by the office issuing the auditor’s report does not seem necessary as long as the list is accessible to the firm issuing the auditor’s report. Furthermore, requiring this information to be prepared and maintained by the office issuing the auditor’s report would likely be very burdensome and time consuming for many large audit engagements, especially during a period of time (i.e., near the auditor’s report date) when the lead auditor’s team would be most busy. Modifying the requirement in AS 1215.19A such that

information is accessible to the firm issuing the auditor's report would also address our concerns related to the requirements in AS 1215.19, which requires that the office issuing the auditor's report obtain, review, and retain certain documents, which include those described in AS 1201.B2(c) and (d).

- The requirements in AS 1215.19 and 19A do not take into account an engagement team that has a multi-tiered structure; the judgments made by the engagement partner or lead auditor on establishing the most appropriate supervisory team; the engagement team's decisions on what constitutes appropriate audit evidence; and the structure of the company that is being audited. We believe it is appropriate for the lead auditor to consider how the company's financial information is consolidated in order to determine how to obtain sufficient appropriate audit evidence and how the audit documentation is best maintained (including obtaining the documentation discussed in AS 1215.19 and 19A); we believe the Proposal may be further enhanced to reflect these judgments. To illustrate this concept, we offer the following example:
 - A company has subsidiaries in the United States, the UK, and other countries. The corporate parent is based in the United States.
 - Accounting Firm #1 is the lead auditor, and audits the U.S. subsidiary and the corporate parent. Accounting Firm #2 is an other auditor, and audits the UK subsidiary.
 - The engagement partner has determined that the work of Accounting Firm #2 on the UK subsidiary will be used as audit evidence. The items noted in AS 1215.19 and 19A will be obtained from Accounting Firm #2.
 - The UK subsidiary has smaller subsidiaries in countries outside of the UK that consolidate into the UK subsidiary. Because of licensing and other laws and regulations, Accounting Firm #3 will be used to perform audit procedures on subsidiaries in countries other than the UK. The lead auditor is appropriately involved in the decisions that Accounting Firm #2 makes, and has determined that Accounting Firm #2 is appropriately supervising any other auditors that are being used.
 - Accounting Firm #2 will obtain the items noted in AS 1215.19 and 19A from Accounting Firm #3, as they are best placed to review and understand the work that has been performed. However, given that Accounting Firm #2 is reporting to the lead auditor on behalf of Accounting Firm #2 and Accounting Firm #3, Accounting Firm #2 will provide the items noted in AS 1215.19 and 19A for the entities audited by Accounting Firm #2 and Accounting Firm #3. Therefore, it would not be necessary for the lead auditor to obtain and keep in the audit documentation of Accounting Firm #1 the items noted in AS 1215.19 and 19A in relation to Accounting Firm #3.
- We do not believe that audit work is performed by "an office"; however, AS 1219.19(e) requires that the office issuing the auditor's report reconcile financial statement amounts to the information underlying the consolidated financial statements. The lead auditor is responsible for determining that the financial statement amounts audited reconcile to the information underlying the consolidated financial statements; therefore, AS 1219.19(e) should be modified to reflect who has this overall responsibility.

Determining the Other Auditor's Compliance with Independence and Ethics Requirements

AS 2101.B4 requires that, in addition to confirming the other auditors' compliance with SEC and PCAOB independence and ethics requirements, the lead auditor is required to understand each other auditor's knowledge of the requirements and their experience in applying the requirements. We agree with the requirement to obtain a written representation from each other auditor that the other auditor is in compliance with SEC and PCAOB independence and ethics requirements. However, it

is unclear whether the requirement is applicable to each individual of the other auditor, to the other auditor engagement team collectively, to the firm, or to the network. We believe there will be significant challenges if the requirement means that the lead auditor needs to evaluate the knowledge and experience of every individual of the other auditor.

For example, one interpretation of this requirement could be that the lead auditor needs to evaluate all of the ethics and independence learning material provided by the other auditor's firm or network. This may be particularly challenging when the other auditor is from a different network than the lead auditor due to the proprietary nature of the learning material developed or delivered by the other auditor to its personnel. The requirements of the PCAOB's Proposal may also be interpreted to mean that the other auditor must provide detailed information about other engagements performed by the other auditor, which may be subject to privacy and confidentiality laws and regulations. In addition, it is unclear whether every member of the other auditor engagement team is expected to provide detailed information on ethics and independence or whether there can be consideration of network-level controls and processes related to monitoring compliance with ethical and independence requirements. Meeting this detailed requirement for each individual across a large, complex, multi-national audit will be challenging, particularly if the lead auditor is unable to leverage a shared system of quality control within the lead auditor's network (if one is present and operating effectively).

We believe a risk-based approach to determining whether to obtain any additional understanding beyond the representation, and if so the nature and extent of that understanding, would be more appropriate. This approach would allow for auditor judgment to be applied and for the auditor's effort to be focused on the circumstances where additional information is important to judgments about the competence of the other auditor, or where contradictory evidence with respect to the other auditors' independence may present itself (as AS 2101.B4 already provides for). Furthermore, we believe the lead auditor should be able to rely on a shared system of quality control at the network level, when found to be operating effectively, to address independence and ethics requirements.

Therefore, we recommend clarifying in AS 2101.B4 to whom the requirement to obtain a written representation from is needed. However, we also believe that based on the engagement partner's professional judgment, including their knowledge of, and experience with, the other auditor, and the facts and circumstances, the lead auditor should be able to determine the additional performance requirements that are appropriate.

Dividing Responsibility for the Audit with Another Accounting Firm

We strongly support retention of the engagement partner's ability to make reference (i.e., divide responsibility) in the auditor's report to another auditor as governed currently by AS 1205. The ability for the lead auditor to divide responsibility for the audit with another accounting firm is a recognized and allowable approach in the United States. There are no compelling practice issues that we are aware of that would suggest a need to change an approach that has long been permitted. We do not believe that additional requirements, including supervisory requirements, are necessary to describe the responsibilities of the engagement partner's firm in situations in which the lead auditor divides responsibility for the audit. We believe that certain aspects of PCAOB Auditing Standard 1206, *Dividing Responsibility for the Audit with Another Accounting Firm* (AS 1206), are in conflict with the Board's goals with respect to divided responsibility, and we further describe our observations and recommendations to the Proposed Auditing Standard below.

The Principles Underlying Division of Responsibility. Currently, the decision to divide responsibility does not happen often and most often occurs when a significant transaction occurs toward the end of the fiscal year and the lead auditor determines that they will not have appropriate time to assume

responsibility for the work performed by the other auditor, or where there is an equity method investment and there is an inability to obtain unfettered access to all people and information in order to assume responsibility for the work of the referred-to auditor. In such circumstances the auditor's report provides transparency to the users of the audited financial statements about the responsibility taken by the lead auditor, as often evidenced with language similar to: "Our opinion insofar as it relates to Subsidiary B is based solely on the opinion of the other auditor."

The Proposal, however, contains additional requirements that go beyond current practice and that may result in more opaqueness around the responsibility and activities the lead auditor is required to undertake with respect to the referred-to auditor, as well as the purpose of such activities. For example, the Proposal (AS 2101.14) requires that the lead auditor have discussions with the referred-to auditor to identify and assess risks of material misstatement associated with the location. As another example, AS 2401.53 requires that the lead auditor discuss with the referred-to auditor the extent of work that needs to be performed to address certain fraud risks.

This greater level of involvement by the lead auditor in the work of the referred-to auditor diminishes the "clear line" with respect to responsibility and what the lead auditor does or does not know about the financial information at that location. For example, based on the discussion mentioned in the previous paragraph, would the lead auditor be compelled to evaluate how the referred-to auditor responded to an identified risk of material misstatement? At what point would the lead auditor be perceived to have gone beyond basing the opinion as it relates to a particular subsidiary or equity method investee "solely" on the referred-to auditor's opinion? The predominant factors influencing the decision to divide responsibility today are primarily timing (e.g., late-year acquisitions) and access (e.g., equity method investments that are not controlled by the company being audited). The increase in the required extent of involvement in the work of the referred-to auditor, and a greater understanding of the referred-to auditor's response to risks, may result in division of responsibility for different factors than exist today. We are not sure whether the Board intended such an outcome. This may be why the Proposal does not carry forward existing guidance (AS 1205.06) which provides considerations in determining whether to make reference to another auditor. However, we find this guidance is used in practice today and we believe it is helpful and should be retained.

Dividing Responsibility when Different Financial Reporting Frameworks Have Been Used. We note the Proposed Auditing Standard eliminates the current option of dividing responsibility when a different financial reporting framework has been used. This option is used in practice today and is recognized by the SEC. The SEC's Financial Reporting Manual (FRM) states "... financial statements of subsidiaries or investees of a foreign private issuer are sometimes prepared in differing GAAP's than that of the registrant. The audit report should be clear as to which auditor is taking responsibility for auditing the conversion of the GAAP of the subsidiary or investee to the GAAP of the issuer, as well as auditing the U.S. GAAP reconciliation" (FRM 6820.7). As far as we are aware, there have been no recognized practice issues or challenges arising from dividing responsibility when a different financial reporting framework has been used.

Given the broad use of International Financial Reporting Standards (IFRS) globally, in a multi-national group audit where subsidiaries have statutory audit requirements, often the financial information of the company is kept in IFRS for statutory audit purposes and then converted to U.S. GAAP for consolidated reporting purposes. With an expected turnover in subsidiary auditors arising from mandatory firm rotation in certain jurisdictions, we believe that an increase in dividing responsibility with a subsidiary auditor may occur. We believe in such a circumstance, where local GAAP is not U.S. GAAP, continuing the current practice of being able to divide responsibility when a different financial reporting framework is used is important.

APPENDIX 2

The comments noted in this section are intended to clarify the auditor performance requirements to avoid misinterpretation.

Obtaining the Other Auditor's Written Report. The Proposal could clarify what will be sufficient for the lead auditor to obtain to satisfy the requirement in AS 1201.B2(d). For example:

- Is it sufficient for the lead auditor to receive only the items noted in AS 1215.19 from the other auditor, provided the receipt of such items results in the lead auditor being appropriately informed about the work performed and the related results?
- Is it sufficient for the lead auditor to obtain only the working papers from the other auditor and not a summary report, provided the receipt of such working papers results in the lead auditor being appropriately informed about the work performed and the related results? For example, if the other auditor performs only an observation of an inventory count, would it be sufficient for the other auditor to provide all working papers to the lead auditor (assuming that the working papers include information such that the lead auditor is appropriately informed about the work performed and the related results)?

Specifically related to Question 53 in Appendix 4, while superseding AI 10 generally seems appropriate, paragraphs .11-.17 are helpful in providing consistency related to lead auditor and other auditor communications; this guidance can be especially helpful when the other auditor is not from the same network as the lead auditor. We recommend retaining or developing new example communications that may be used, together with an explanation of when different types of communications might be more appropriate. For example, we believe it would be helpful for additional clarity to be provided about the circumstances that may necessitate or require an opinion-style report from the other auditor to the lead auditor.

Discussions with Other Auditors. AS 2101.14 requires the lead auditor to discuss 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. However, the lead auditor may initially identify and assess risks *prior* to determining the locations where procedures will be performed to respond to those risks (and therefore prior to identifying an other auditor). It is important that the standard recognize the iterative nature of the planning process to enable risk assessment activities and other auditor outreach to occur appropriate to the facts and circumstances and less in a seemingly required sequential manner.

Specialized Skill or Knowledge. Clarity is needed as to the purpose for the proposed wording in AS 2101.16, which states “[t]he 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.” There are many examples of where specialized skills may be needed and the current wording allows for appropriate consideration. Additional clarity as to why there is an added focus on knowledge of foreign jurisdictions is needed, especially in light of this requirement being applicable to “the auditor” (e.g., the auditor in a foreign jurisdiction is now required to consider whether knowledge of the foreign jurisdiction in which they practice is necessary). While Page A4-25 of the Release implies that the reasoning for this change is to assist with gaining an understanding of the qualifications of the other auditor’s supervisory personnel (and who assist the lead auditor with planning or supervision), the explanatory phrase added to AS 2101.16 does not appear to achieve this goal.

Changes in Audit Procedures. AS 1201.B2 (b) states that the lead auditor should “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.” Requiring that changes in the nature, timing, and extent of audit procedures be in writing in all cases seems overly onerous and inconsistent with current practice of how the engagement partner (or engagement team members who assist with fulfilling the engagement partner’s responsibility pursuant to AS 1201) would manage communications about necessary changes in work performed by engagement team members. Determining whether changes to audit procedures are necessary and making the necessary communications often involves a collaborative effort between engagement team members and results in direct changes to related working papers (versus a separate document identifying the change, in addition to the change in the related working paper). As the lead auditor has the ability to review working papers of the other auditor, the lead auditor has the ability to determine that changes to audit procedures were appropriately incorporated; therefore, having an additional layer of documentation seems unnecessary.

Recommended Changes to Provide Clarity When Dividing Responsibility. In light of our analysis of the Proposed Auditing Standard, we have identified several areas where improvements may be warranted to provide further clarity for auditors:

- AS 1206.2 states that “[t]he 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...” This phrasing implies that the object of the lead auditor is to communicate with the referred-to auditor as it relates to the audit procedures to be performed with respect to the consolidation, which we do not believe is the intent. We recommend that the PCAOB consider modifying the objective to make it clear that the objective of the lead auditor is to perform procedures that are necessary in order to make reference to the report of the referred-to auditor in the lead auditor’s report, and make the necessary disclosures in the lead auditor’s report.
- AS 1206.08(b) states that the lead auditor’s report should “[i]dentify 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.” Given that the referred-to auditor’s report is included in the filing, it does not seem necessary to identify them specifically by name in the auditor’s report. We recommend the PCAOB re-consider the necessity of this requirement.
- AS 1206.08(c) states that the lead auditor’s report should “[d]isclose 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.” Furthermore, the second note to AS 1206.1 states that “[t]his 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 [AS 1206] in relation to each of the referred-to auditors individually.” In current practice, if there is more than one referred-to auditor, the auditor’s report generally combines the disclosure about the magnitude of the portion of the company’s financial statements and, if applicable, internal control over financial reporting, for all referred-to auditors, which has been a longstanding and accepted practice with auditor’s reports filed with the SEC. We recommend that the Board clarify whether the intention is to require that this information be disclosed for each referred-to auditor and consider, in making this clarification, how this would conflict with current practice and what is currently acceptable to the SEC. In addition, we request that the PCAOB include an illustrative report example when multiple referred-to auditors exist in the final standard.

- AS 1206 does not appear to have sufficient guidance on dividing responsibility for an audit of internal control over financial reporting, as the Proposed Auditing Standard appears to be heavily focused on the financial statement audit. Some examples that lack reference to audits of internal control over financial reporting include:
 - AS 1206.1: Note: This standard applies when the lead auditor divides responsibility for the audit with one or more other auditors.
 - AS 1206.4: 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.

It would be more appropriate for the reference to “the audit” in the above examples to refer to both the financial statement audit and the audit of internal control over financial reporting given that the auditor can divide responsibility for the financial statement audit or the audit of internal control over financial reporting. Alternatively, when phrases such as “the audit” are used, they could be footnoted and clarified that such phrases refer both to the audit of the financial statements and the audit of internal control over financial reporting, if applicable.

- AS 1206.01 states “[t]his standard establishes requirements for the lead auditor 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.” However, we have observed that throughout the Proposal there are auditor performance requirements when a referred-to auditor exists (e.g., Appendix B to AS 1201). Accordingly, we recommend that the Board clarify in the Proposed Auditing Standard that requirements exist in other PCAOB standards related to when the lead auditor divides responsibility and that an appendix or footnote reference be added that identifies such other requirements.
- It is unclear as to why in situations where the lead auditor is unable to divide responsibility with another accounting firm, the lead auditor’s performance requirements are limited only to the three options presented in AS 1206.7. We believe that another alternative is to allow for the lead auditor to identify a different other auditor and appropriately apply the requirements of the Proposal when using an other auditor. Therefore, we recommend that this additional alternative be included in AS 1206.7.
- We recommend that in AS 1206, Appendix B, an example is provided for the situation in which the lead auditor is making reference to a referred-to auditor for the financial statement audit only, and the lead auditor’s report on the financial statements is separate from the lead auditor’s report on internal control over financial reporting (given that this is the most common scenario that is encountered).

APPENDIX 3

<p>AS 1201.B(2)(b)</p>	<p>We recommend making the following changes to improve readability and clarify the meaning:</p> <p>Note: Based on the necessary extent of supervision of the second other auditor's work by the lead auditor, it may be necessary for the lead auditor (rather than the other auditor who is assisting the lead auditor in supervising the second other auditor) to determine the nature, timing, and extent of procedures to be performed.</p>
<p>AS 1206.03</p>	<p>We recommend making the following changes to improve readability and clarify the meaning:</p>

	<p>The lead auditor should determine that audit procedures are performed, in coordination with the referred-to auditor, <u>as necessary</u>, to test and evaluate...”</p>
<p><i>AS 1206.7</i></p>	<p>It is unclear that the circumstances described in AS 1206.7 exist in situations where the lead auditor originally expected to divide responsibility with the referred-to auditor, and has subsequently determined that this is not possible. Therefore, we recommend making the following changes:</p> <p>In situations in which the lead auditor <u>originally planned to divide responsibility for the audit with another accounting firm, but has subsequently determined that this is not possible is unable to divide responsibility with another accounting firm</u> (e.g., due to concerns about the competence or independence of the referred-to auditor), the lead auditor should:...</p>
<p><i>AS 1206.08(c)</i></p>	<p>We recommend the following change to AS 1206.08(c), given that the second sentence states “[t]his may be done,” and therefore using “or” instead of “and” provides flexibility as to the criteria used (as total assets and total revenues are not always the criteria used):</p> <p>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, <u>or and</u> other appropriate criteria necessary to identify the portion of the company’s financial statements audited by the referred-to auditor.</p>
<p><i>AS 1206, Footnote 1</i></p>	<p>We recommend making the following changes to clarify the meaning:</p> <p>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, <u>as well as the financial information related to equity method investments</u>.</p>
<p><i>AS 1206.B1</i></p>	<p>We recommend the following changes to AS 1206.B1, the first paragraph of the Introductory Paragraph, to improve readability and to clarify that the statement of comprehensive income is not part of stockholders’ equity:</p> <p>We have audited the accompanying consolidated balance sheets of X Company and subsidiaries as of December 31, 20X3 and 20X2, and the related consolidated statements of operations, <u>comprehensive income, and</u> stockholders’ equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 20X3.</p>
<p><i>AS 1206.B1</i></p>	<p>We recommend the following changes to AS 1206.B1, the Opinion Paragraph, to address grammar inconsistencies (first sentence) and to recognize that the opinion on the effectiveness of internal control over financial reporting is only for one year (second sentence):</p> <p>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 <u>its their</u> operations and <u>its their</u> 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:</p>

	<p>2013 issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)”).</p>
<p><i>AS 1206.B1</i></p>	<p>We recommend the following changes to AS 1206.B1, the second Introductory Paragraph, to better reflect that the auditor’s opinion is on the effectiveness of internal control over financial reporting:</p> <p>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, respectively, and total revenues constituting XX percent, YY percent, and ZZ percent of consolidated revenues for the years ended December 31, 20X3, 20X2, and 20X1, respectively. Those financial statements and B Company’s internal control over financial reporting were audited by Firm ABC whose report[s] has[have] been furnished to us, and our opinions, insofar as they relate to the amounts included for B Company and <u>the effectiveness of</u> its internal control over financial reporting, are based solely on the report[s] of Firm ABC.</p>
<p><i>AS 1215.19A</i></p>	<p>We recommend the following change to clarify that retention of work papers is by the office (as is consistent with AS 1215), not the lead auditor:</p> <p>Audit documentation of the <u>firm office</u> issuing the auditor's report must contain a list of additional work papers of other auditors (beyond those described in paragraph .19 [of AS 1215]) that were reviewed by the lead auditor but not retained by the <u>firm issuing the auditor’s report lead auditor</u>, if any.</p>
<p><i>AS 1215.18, AS 1215.19, and AS 115.19(e)</i></p>	<p>It unclear as to what the reference to “other offices of the firm” means (i.e., offices of what firm?) in certain paragraphs in AS 1215. We recommend making the following changes to improve readability and clarify the meaning (see additional comments on AS 1215 in Appendix 2):</p> <p>AS 1215.18: 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 <u>issuing the auditor’s report</u> and other auditors must be retained....</p> <p>AS 1215.19: 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 offices of the firm <u>issuing the auditor’s report</u> and other auditors:...</p> <p>AS 1215.19(e): Sufficient information to enable the office issuing the auditor’s report to agree or to reconcile the financial statement amounts audited by other offices of the firm <u>issuing the auditor’s report</u> and other auditors to the information underlying the consolidated financial statements.</p>
<p><i>AS 2101.A3(a)(2)</i></p>	<p>AS 2101.A3 (a)(2) states that the engagement team includes “specialists whose work is used on the audit and who are employed by the lead auditor or another accounting firm participating in the audit.” It is unclear as to how specialists whose work is used on the audit should be considered when they are neither employed nor engaged by the lead auditor or another accounting firm participating in the audit. For example, a specialist (e.g., an IT Specialist) may be a Partner in the same firm as the lead auditor; in such a case, they would not be considered to be “employed by the lead auditor,” nor would they be an “engaged specialist.” We recommend the following change:</p>

	<p>a. Engagement team includes – ...</p> <p>(2) Specialists whose work is used on the audit and who are partners, principals, shareholders, or employees of the registered public accounting firm issuing the auditor’s report employed by the lead auditor, or of another accounting firm participating in the audit</p>
<i>AS 2101.A4</i>	<p>We recommend making the following changes in order to acknowledge that there may be instances where an auditor’s report may not ultimately be issued:</p> <p>Lead auditor –</p> <p>(a) The registered public accounting firm engaged to issue issuing the auditor’s report on the company’s financial statements and, if applicable, internal control over financial reporting; and</p> <p>(b) The engagement partner and other engagement team members who: (1) are partners, principals, shareholders, or employees of the registered public accounting firm engaged to issue 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.</p>
<i>AS 2101.A5</i>	<p>We recommend making the following changes in order to conform to language used in the definition of engagement team:</p> <p>Other Auditor –</p> <p>(a) A member of the engagement team who is not a partner, principal, shareholder, or employee of the registered public accounting firm engaged to issueing the auditor’s report lead auditor; and</p> <p>(b) A public accounting firm, if any, of which such engagement team member is a partner, principal, shareholder, or employee.</p>
<i>AS 2101.A6</i>	<p>We recommend making the following changes to the definition of referred-to auditor, which is consistent with the terminology used in the Note to AS 2101.A4 and current practice:</p> <p>Referred-to Auditor – A public accounting firm, other than the engagement partner’s registered accounting firm 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 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.</p>
<i>AS 2101.B2</i>	<p>We recommend making the following changes to improve readability and clarify the meaning:</p> <p>In making this determination, the engagement partner should take into account 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 (which includes considering the portion’s materiality of 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.</p>
<i>AS 2101.B4</i>	<p>We recommend making the following changes to improve readability and clarify the meaning:</p>

	<p>In an audit that involves other auditors, the lead auditor should determine each other auditor’s compliance with the SEC and PCAOB independence and ethics requirements <u>in the context of the engagement</u> by...</p>
<p><i>Use of term “public accounting firm”</i></p>	<p>Generally, the Proposal uses the term “accounting firm” or “registered public accounting firm.” However, in certain instances the term “public accounting firm” is used. If there is not an intended difference in the use of these terms, we recommend that the Proposal refer consistently to “accounting firm” or “registered public accounting firm.” We recommend making this change to the following paragraphs (and also recommend that the Board consider whether additional instances of the term “public accounting firm” need to be changed):</p> <ul style="list-style-type: none"> • AS 2101.A5(b) and A6 • AS 1201.A5 • AS 1215 Footnote 4 • AS 1206.A3 • AS 2201.C1.

Coordination and Communication Challenges in Global Group Audits

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July 2016

Acknowledgements: The authors are grateful to personnel of several public accounting firms who aided in the development of our data collection instrument by providing their perspective on the current environment with respect to global group audits, or provided responses to the survey. Additionally, we thank Lindsay Andiola, Katie Byrne, Mara Cameran, Nathan Cannon, Elizabeth Carson, Carol Dee, Karla Johnstone, Marsha Keune, Anne Lastowski, Christine Nolder, Melissa Reville, Joseph Schroeder, Greg Trompeter, Sam Woolford, participants at the 2015 International Symposium on Audit Research, the 2015 European Audit Research Network Symposium, the 2016 AAA Auditing Section Midyear Meeting, and the 2016 European Accounting Association Congress, as well as accounting research workshop participants at Bentley University, Indiana University, the University of Arizona, the University of Wisconsin-Madison and West Virginia University, for comments on prior versions of this paper. We also gratefully acknowledge the research assistance of Steve Breskiewicz and Nicholas Maiale. Funding for this research was provided by the Center for Audit Quality. However, the views expressed in this article and its content are those of the authors alone and not those of the Center for Audit Quality. Denise Hanes Downey acknowledges the support of the Center for Global Leadership at Villanova University.

Coordination and Communication Challenges in Global Group Audits

ABSTRACT

This paper investigates coordination and communication challenges faced by auditors in performing global group audits. Prior research suggests that managing geographically distributed work can be problematic when diverse teams perform interdependent activities in complex business environments. Studying factors that differentiate global group audit experiences perceived as challenging, we find that complexity arising from client size/regulatory status and global structure contribute strongly to challenges, while language/cultural barriers are less important. We investigate the extent to which three specific coordination and communication strategies mitigate these effects: (1) tacit coordination methods (leveraging common ground between team members based on shared knowledge); (2) modularization (planned reduction of interdependencies between team members); and (3) ongoing communication methods (building and using communication channels). Results show that greater component auditor knowledge and engagement experience (tacit coordination) are associated with lower probability of challenges overall. Effects of other strategies are contingent on the nature and level of complexity. Our results provide initial evidence on factors contributing to challenges faced by group auditors and offer insights on how to address them.

Keywords: Group audits; Geographically distributed work; Coordination; Communication; Audit quality

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I. INTRODUCTION

Global group audits have gained prominence in the past two decades due to the increasing globalization of business. Based on inspection findings, the U.S. Public Company Accounting Oversight Board (PCAOB) has expressed concern about U.S. group auditors' supervision and review of work performed by audit firms in foreign jurisdictions (termed "component auditors"). The key root causes of deficiencies identified by the PCAOB are challenges associated with the coordination and communication of work across international boundaries among the multiple firms involved (Doty 2011c; Munter 2014; PCAOB 2016). The purposes of this research are to increase understanding of these root causes by identifying factors contributing to these challenges in managing global group audits, and to provide initial evidence regarding whether strategies used by audit firms mitigate their effects.¹

The PCAOB's concerns extend to engagements in which group and component auditors are members of the same global network firm (Doty 2013). Given that global network firms operate under common branding, with shared reputational risk (e.g., Cahan, Emanuel, and Sun 2009; Saito and Takeda 2014), knowledge management systems (Carson 2009), and electronic work tools (Dowling 2009), this is perhaps surprising. However, performing the lead role in auditing a global entity is a considerable management feat, even within a global network. As the lead team, the group auditor must supervise work of multiple, geographically dispersed teams to produce the audit opinion under time and budget constraints. While many large U.S. audit engagements involve multiple domestic offices, the difficulties of managing teams are exacerbated when significant components are located overseas. Not only are the affiliate firms different legal entities, with their own governance and incentive structures, but differences in language, culture, customs, professional training and experience are also likely to complicate

¹ Consistent with International Standard on Auditing 600 (ISA 600; IFAC 2007), we refer to the consolidated entity as the "group" and local business units of the client as "component(s)" of the entity. We refer to the lead auditor who signs the consolidated financial statement opinion as the "group auditor" or "group engagement team". The "component auditor" or "component engagement team" refers to audit firms engaged in foreign jurisdictions to perform work over local business units. We use the term "firm" to refer to the audit firm only, and "client" to refer to the audited entity. ISA 600 is the primary base for the methodologies of the global firm networks, which include certain other procedures required by the PCAOB (PCAOB 2016).

engagement management (PCAOB 2016). Further, local laws and regulations can prevent auditors from sharing workpapers across geographic boundaries. These features of the group audit environment create additional sources of complexity that could inhibit coordination and communication across teams, beyond those experienced in a domestic audit.

Thus, study of global group audits is important due to the deficiencies identified by PCAOB inspections, and the potentially broad impact that a global group audit failure could have on the financial system (Doty 2011c). However, only a few studies consider the interaction of audit firms on engagements across international boundaries. Asthana, Raman, and Xu (2015) and Hung, Ma, and Wang (2014) both show that audits of foreign U.S. issuers signed by non-U.S. audit firms have lower audit quality relative to those signed by U.S. audit firms. These studies imply that U.S. group auditors might have difficulty in managing the work of foreign auditors when they perform component work; however, due to data limitations these samples are not limited to group audits. Dee, Lulseged, and Zhang (2015) provide more direct evidence, showing lower audit quality and negative market reactions for U.S. issuers using a component auditor that does not itself sign audit opinions in the U.S. (likely to be small, foreign firms), relative to U.S. issuers with a comparable principal auditor and foreign revenues.² While these studies suggest audit quality issues in global group audits, they do not address the PCAOB's concern regarding problems in coordination and communication among U.S. and non-U.S. firms as a source of deficiencies. To gain insight into this issue, audit process data are needed. Barrett, Cooper, and Jamal (2005) provide relevant evidence from a single 1997 engagement involving a Canadian component auditor and a small European firm acting as group auditor. Their interview data identify coordination and communication problems, despite the low-risk nature of the engagement and considerable client-specific experience of participants. In sum, while limited extant research provides glimpses into the group audit, research has not

² Archival research on U.S. group audits is limited because disclosure of component auditors is not required. Carson, Simnett, Trompeter, and Vanstraelen (2016), using disclosures in Australia, find no differences in quality for group audits of Australian issuers performed by Big 4 firms when a component auditor is involved, whether the component auditor is within or outside the group auditor's network. However, that study does not directly address the PCAOB's concern about participation of non-U.S. firms in U.S. audits, as all audit opinions in their sample are signed by Australian firms.

yet investigated factors that exacerbate coordination and communication challenges or the effectiveness of strategies designed to mitigate the impact of exacerbating factors on those challenges.

We address this topic by studying a sample of audits of multinational entities led by U.S. group auditors in the current regulatory environment, using data obtained through the Center for Audit Quality.³ We ground the study in the management literature on coordination and communication challenges that arise when work is distributed across multinational boundaries. This literature indicates that such challenges are likely to be exacerbated when teams perform interdependent activities in a complex environment. Particularly, challenges increase when teams working interdependently have difficulty anticipating each others' actions and cannot directly view those actions; that is, when "reciprocal predictability of action" is inhibited (Srikanth and Puranam 2011, 849). The more complex the environment, the greater the coordination and communication challenges, as teams will have difficulty viewing and monitoring each others' work. We study the influence of several sources of complexity suggested by prior research in auditing and other contexts, as well as regulators' concerns, including client size, regulatory status, and cultural/language barriers between firms.

To mitigate the challenges arising from performing distributed work in complex environments, the management literature identifies several strategies that organizations may adopt. First, studies of geographically distributed work note that *tacit coordination* strategies (leveraging and developing common ground between team members through shared experience and knowledge) can increase reciprocal predictability of action, thereby reducing the effects of complexity on coordination and communication challenges (Srikanth and Puranam 2011, 2014). Second, the management literature suggests that the effects of complexity can be attenuated through *modularization* of work; i.e., advance planning to minimize interdependencies and standardize interactions between team members (Sanchez and Mahoney 1996; MacDuffie 2007; Srikanth and Puranam 2011). Third, prior research indicates that *ongoing communication* strategies (frequent and open communication, and employing methods providing

³ All group auditors in our sample are member firms of large global networks, and are subject to the U.S. regulatory environment and legal system (i.e., the typical situation in audits of U.S. multinational entities). Limitations on data availability prevent comparing this sample with group audits led by smaller U.S.-based firms, or by non-U.S. firms.

more situational information and informational cues) can increase ability to anticipate and review others' actions, mitigating effects of complexity (e.g., Walther 2002; Vlaar, van Fenema, and Tiara 2008; Srikanth and Puranam 2011). This literature leads to our main effects hypotheses that sources of complexity will be positively associated with challenging global group audits, and coordination/communication strategies will mitigate challenges overall. However, there is tension in these questions, as prior studies are conducted in routine business settings (e.g., student virtual teams and offshoring of back office services and call centers). Therefore, the extent to which these findings generalize to the highly complex, regulated context of auditing is unknown. In addition to addressing these hypotheses, we also study whether coordination/communication strategies mitigate the effects of specific sources of complexity on challenges faced in managing global group audits.⁴ To investigate, we include in our models a series of interactions of complexity factors and strategy factors. Because the literature provides insufficient basis for predictions at this level of specificity, we pose the following research question: which coordination and communication strategies reduce challenges associated with specific sources of complexity?

We address our research purposes using perceptions of highly experienced U.S. audit professionals regarding actual global audits in which they participated as a member of the group engagement team. In order to distinguish factors contributing to difficulty in managing these engagements, we used two versions of an experiential questionnaire: one in which participants selected and described a component of an engagement with significant challenges, and another in which challenges were of little significance (hereafter termed “non-challenging”). Our sample comprises 147 observations with complete data on within-network global group audits from multiple participating Big 4 firms. From prior literature, audit regulation, and assistance of professionals at participating firms, we developed measures of the constructs of complexity and strategies (modularization, tacit coordination, and ongoing communication) relevant to global group audits. We developed factors representing each

⁴ For example, does modularization of work mitigate challenges experienced in managing group audits of very large clients, or when language/cultural barriers are higher?

construct, and address our hypotheses and research question using probit regressions whose dependent variable represents an engagement selected by the participant as challenging vs. non-challenging. Independent variables include main effects for complexity factors, strategy factors, and the interactions of complexity and strategy factors. As all three strategies are costly for firms to implement, it is important to identify when a particular strategy shows greater benefit, i.e., mitigating the effect of a given source complexity on challenges across the sample, or when that source of complexity is relatively high.⁵

Factor analysis of complexity variables yields three significant factors, representing the client's size/regulatory status, the client's global structure (a greater number of components and requirement that the component team also perform the statutory audit)⁶, and language/cultural barriers. Model results suggest that tacit coordination strategies are highly important in mitigating the impact of complexity on engagement challenges. Specifically, greater component auditor engagement experience and staff stability mitigate effects of complexity due to both client global structure and language/cultural barriers. Component auditor engagement experience also mitigates the effects of complexity due to large/public clients. Further, greater component auditor knowledge mitigates challenges associated with all three sources of complexity. For audit firms, these results suggest that staffing experienced, stable, and knowledgeable component audit teams is valuable in achieving a smooth and efficient global group audit. However, the extent to which group auditors have knowledge of component auditor qualifications, and can influence staffing of component teams, are open questions (e.g., Goelzer 2009; Asthana et al. 2015).

Results for the other strategies are not as pervasive, despite their prevalence in large global networks. For example, modularization involves advance scripting of work to be done by component teams to reduce later interdependencies. The only circumstances in which we find that greater

⁵ Our tests measure the associations of group auditors' perceptions of sources of complexity and use of strategies with the likelihood that engagements were selected as challenging vs. non-challenging. The nature of these data does not permit assertions of causality. While a methodological concern is that strategy choice may be endogenous (i.e., certain strategies are more likely to be adopted for more complex clients), the empirical correlations between complexity and strategy factors in our sample are low. We use the term "mitigate" as shorthand to describe significant negative coefficients of strategies in the models.

⁶ Local statutes in foreign jurisdictions often require that an audit be performed over the financial statements of the local business operations. While requirements vary, such audits are typically referred to as "statutory audits".

modularization mitigates challenges are when complexity due to size/regulatory status is low (i.e., smaller, nonpublic companies) and when complexity due to global structure is high (i.e., there are many components, and statutory audit requirements create different incentives). These results imply that the greatest net benefit of modularization is observed when the group auditor is managing a larger number of component teams, inhibiting effective monitoring.

We also find some instances in which ongoing communication strategies mitigate challenges, contingent on the level of complexity. Greater involvement of the component auditor in meetings (engagement kickoff, discussion of instructions, and fraud brainstorming) mitigates challenges associated with more complex global structures as well as with higher language/cultural barriers. Greater availability/use of electronic tools also mitigates challenges from higher language/cultural barriers. While this finding is valuable, it is interesting that electronic tools do not mitigate effects of complexity due to size/regulatory status or global structure, given their prevalence in U.S. Big 4 firms. While the firms often tout their global methodologies, it may be that availability/use of electronic tools across global firm networks is limited compared to their U.S. affiliates (e.g., Saito and Takeda 2014).

At a high level, our results show that group auditors face complexity from a number of sources, and that the most effective mechanism to address challenges is an experienced, stable, and knowledgeable component auditor team. While other strategies, such as advance partitioning of engagement activities and greater availability/use of electronic tools, help in some circumstances, they do not always provide the intended benefit. In producing these findings, this study contributes to the literatures in auditing and geographically distributed work. While limited prior research provides some support for regulators' concerns regarding quality of global group audits, the current study provides unique evidence of the sources of complexity that increase challenges that group audit leaders encounter on these engagements and strategies to mitigate such effects. Thus we contribute to the understanding of how global group audits are managed, as well as mechanisms that might improve effectiveness and efficiency.

This paper proceeds as follows. The next section presents relevant background and prior research. The third section reviews theory and develops hypotheses. The fourth section describes the research

method. The fifth section presents the results, and the final section provides conclusions and limitations.

II. BACKGROUND AND PRIOR AUDITING RESEARCH

The Global Group Audit Environment

Many companies headquartered in the U.S. maintain foreign operations and/or assets in other countries. In 2012, U.S.-domiciled multinational corporations added \$4.7 trillion of value to the global economy, employing 35.2 million people worldwide (BEA 2014). For many of these corporations, foreign operations are highly significant to the overall business.⁷ The ability to provide cross-border audit services to large, global companies is important to audit firms, who have worked with trade organizations and nation-states to promote the globalization of auditing over the last several decades (Suddaby, Cooper, and Greenwood 2007). At the same time, audit firms themselves have grown into large international entities, expanding their global networks to encompass hundreds of national partnerships or affiliates operating under a common brand (Suddaby et al. 2007). The network structure permits group auditors to more easily leverage qualified professionals across jurisdictions, and comply with the requirement in most countries that audit professionals be locally licensed to provide services (Carson et al. 2016).

To opine on the financial statements of a multinational corporation, audit firms often engage foreign firms within and/or outside their global networks to audit the company's operations in foreign jurisdictions. These component auditors, on average, perform work over one-third to one-half of total assets and total revenues for the consolidated company (PCAOB 2016). "For many large, multinational companies, a significant portion of the audit may be conducted abroad – even half of the total audit hours" (Doty 2011b). Further, component auditors are involved in approximately 55 percent of audits performed by U.S. global network firms and 80 percent of audits of Fortune 500 companies (PCAOB 2016). PCAOB observations suggest that U.S. audit firms rely largely on component auditors within their global network (Doty 2011b, 2011c), likely due to ease/efficiency and the common audit methodologies typically espoused across these networks (e.g., Winograd, Gerson, and Berlin 2000).

⁷ For example, foreign operations of The Coca-Cola Company accounted for \$27 billion (58 percent of total net operating revenues for the consolidated company) in 2013 (Coca-Cola Co. 2014).

All global audit firm networks have policies that are intended to promote continuity in client service across the brand name (Humphrey, Loft, and Woods 2009). However, member firms are also subject to the laws and regulations of their local jurisdictions, and primarily focus on providing services to locally owned entities, as opposed to local components of multinational corporations (Cooper, Greenwood, Hinings, and Brown 1998; Carson 2009). Thus, member firms do not passively adopt global methodologies, but rather adapt them to their local environments (Barrett et al. 2005). This raises the question of the extent of consistency achieved across global networks. Two recent studies examine audit quality in U.S.-listed foreign companies, finding that audit quality is lower when non-U.S. auditors sign the financial statement opinion, relative to U.S. auditors (Asthana et al. 2015; Hung et al. 2014). Although initial PCAOB inspections are associated with improvements in audit quality for non-U.S. firms, differences in quality are still observed. These results underscore the higher deficiency rates for non-U.S. member firms observed in PCAOB inspections (PCAOB 2016).

Global Group Audit Methodologies and Prior Research

International Standard on Auditing (ISA) 600, the basis for global network firms' methodologies (PCAOB 2016), requires the group auditor to direct and supervise all work pertaining to the financial statement audit opinion for the consolidated entity, including work performed by component auditors (IFAC 2007). The group auditor is responsible for setting the overall audit strategy, including materiality at both the group and component levels. For sufficient and appropriate evidence to be obtained, all components that are financially significant to the group must be audited and procedures must be performed over components presenting significant risk of material misstatement (IFAC 2007).

When relying on a component auditor to perform a portion of the audit work, the group auditor is required to discuss risks with the component auditor, communicate requirements and relevant information, and evaluate the component auditor's work (IFAC 2007). To evaluate the component auditor's work, the group auditor reviews what is commonly referred to in practice as a "reporting package", summary documentation of the work performed and the conclusions reached. Due to legal restrictions, reporting packages typically do not contain the actual supporting workpapers or original

evidence, and the group and component auditors typically do not possess access to each other's engagement files. Following the evaluation of the component auditor's reporting package, auditing standards require the group auditor to discuss significant matters that have arisen and to determine whether review of additional documentation is necessary (IFAC 2007).

In sum, the group auditor typically has full responsibility for signing the audit opinion, but must rely on multiple other firms performing parts of the overall engagement, with limited ability to observe the processes that the other firms use to perform their duties. Under these circumstances, audit quality depends on effective coordination and communication between group and component auditors. However, in 2013 PCAOB inspections identified audit deficiencies in more than 40 percent of work performed on group audits by foreign component auditors, which are linked to coordination and communication failures (PCAOB 2016). Examples include unresolved issues between the group and component auditors, noncompliance with group auditor instructions, insufficient audit testing, and failure of component auditors to communicate significant issues (Doty 2011c; Munter 2014; PCAOB 2016). Figure 1 presents detailed quotes describing inspection observations and global group audit concerns from the PCAOB.⁸

Insert Figure 1 About Here

While regulators are concerned about the quality of global group audits, very limited empirical research specifically investigates the effects of reliance on component auditors. Dee et al. (2015) compare U.S. audits for which PCAOB Form 2 disclosure indicates participation of a component auditor that does not sign an opinion for any U.S. issuer. Comparing those engagements to a matched sample with no disclosure (which may or may not have component auditors that *do* sign U.S. audit opinions in their own right), they find that initial disclosure of other audit participants is associated with a negative market reaction, declining earnings response coefficients, and higher discretionary accruals.

The qualitative study by Barrett et al. (2005) provides information on interactions among participants in a single global group audit in the late 1990's, primarily focusing on a Canadian component audit team and its interactions with a smaller European network member firm serving as group auditor.

⁸ International regulators have expressed similar concerns about group audits (e.g., IFAC 2015).

The engagement was perceived as “satisfactory” by participating auditors, the client was low risk, and team leaders had considerable client-specific experience. To coordinate the component audit work, the group auditor relied heavily on inter-office instructions to create a standardized plan. At the time of data collection, the network was also rolling out a revised audit methodology intended to achieve international consistency through use of technology. Prior management research that we cite in the following section suggests that these features should mitigate the effects of complexity on coordination and communication, and yet Barrett et al. (2005) find evidence that difficulties still persisted.

Building on this limited base of audit research, we study factors that differentiate global group audits in which communication and coordination are not perceived as satisfactory. In the next section, we review theory and develop our expectations regarding specific features of the client and the engagement.

III. THEORY AND RESEARCH EXPECTATIONS

Sources of Complexity

We first consider sources of complexity that could lead to challenges in performing global group audit engagements. The management literature suggests that coordinating and communicating activities are facilitated when teams have “reciprocal predictability of action” (Puranam and Raveendran 2012).⁹ When work is interdependent, failures in coordination and communication (e.g., delays and misunderstandings) can result when others’ actions are difficult to predict (Puranam and Raveendran 2012). In auditing, interdependence of work arises from the need to integrate results of group and component teams’ work to produce the final opinion. In the context of global group audits, we propose that the difficulties associated with performing interdependent work are likely to be exacerbated by complexity arising from client characteristics and the nature of the work, the structure of the engagement, and cultural/language barriers. Below, we discuss examples of each of these three types of complexity.

First, communication difficulties are likely to increase when the client is larger, an SEC registrant, and/or the work is more complex (e.g., Hay, Knechel, and Wong 2006). Larger, public U.S. companies require more extensive audit work and pose greater risk (e.g., audit, litigation, and regulatory).

⁹ See Hanes (2013) for a recent summary of this literature and its applications to the auditing context.

Component auditors in other countries may find it difficult to predict and/or understand the group auditor's actions and instructions due to differences with the local jurisdiction. Further, larger public companies are likely to engage in transactions that increase the complexity of the component auditor's work (e.g., acquisition activity or multi-deliverable revenue arrangements). Such features of larger, public companies increase the auditor's coordination and communication costs, possibly leading to challenges in performing the engagement (Hinds and Bailey 2003; Jensen and Szulanski 2004; Kankanhalli, Tan, and Wei 2006).

Second, the structure of a global group audit is also likely to impact its level of complexity. Global group audits can differ considerably in the number of components spread across the globe. As the number of components increases, the group auditor must explain the audit strategy to more component teams and monitor their work to assess the sufficiency and appropriateness of the evidence obtained. In these situations, the coordination and communication required to obtain adequate understanding of each component's activity could constrain group auditor resources, amplifying challenges. Group audits can also differ in organizational structure, including the involvement of other teams, multiple levels of reporting, and the component's statutory audit responsibilities. Figure 2 shows that for some engagements, the group engagement team engages a team other than the component auditor to perform work over a portion of the component (e.g., accounts receivable processed at a shared service center). In such instances, the other team is likely to communicate with the group auditor, who must then disseminate relevant findings to the component auditor. In other engagements, the group team works directly with a "supervising component" team, which manages audit work done by one or more sub-components and reports the consolidated work to the group auditor. As a result, the sub-components report indirectly to the group auditor through the supervising component team. The resulting multiple levels of required coordination and communication could reduce reciprocal predictability of action between group and component teams, exacerbating challenges (Puranam and Raveendran 2012). Statutory audits are also likely to increase the complexity of group audits, requiring work be performed on different timelines, at a lower materiality level, and to a varying extent than the group audit. In

creating conflicting pressures and incentives for component auditors, statutory audits create another level of work that could impact coordination and communication challenges experienced on the group audit.

Insert Figure 2 About Here

Third, engaging component auditors in foreign jurisdictions in which the client does business is also likely to increase the difficulty of performing interdependent work due to complexities associated with differences in language and culture, as noted by the PCAOB (2016). Such differences could create greater variation in team members' judgments and decisions (Nolder and Riley 2014), and make it more difficult for teams to establish a mutual understanding (e.g., Kiesler and Cummings 2002).

In sum, limited prior literature and regulators' concerns identify a number of factors that might be associated with increased challenges in performing a global group audit. While we propose the following general hypothesis on effects of complexity, there is insufficient basis for an *ex ante* prediction regarding which specific sources might be relatively more important in this context.

H1: Sources of greater complexity are positively associated with coordination and communication challenges experienced in global group audits.

Coordination and Communication Strategies

Once a given engagement is undertaken by a U.S. firm, the sources of complexity identified above are largely determined. However, the group audit firm and engagement team can implement specific strategies intended to reduce the impact of those features on engagement management. We consider several coordination and communication strategies, which the management literature supports as ways to improve success in managing interdependencies between teams performing distributed work: (1) *tacit coordination*; (2) *modularization*; and (3) *ongoing communication*, (illustrated in Figure 3). As detailed below, these strategies resonate in the auditing context, as they are discussed by audit firms as part of their operating practices, and/or are topics of auditing research. The management literature promotes them as theoretically appealing, and finds some to be effective in simple contexts (e.g., student virtual teams, or offshoring of routine tasks such as back office services and call centers). However, extension of these findings to the global group auditing context is uncertain, as this context features

interaction of multiple teams from independent firms across countries, performing a highly complex and judgmental task within a limited time, often with regulatory restrictions on information sharing.

Insert Figure 3 About Here

Tacit Coordination

Tacit coordination focuses on establishing a common ground of understanding between team members, which should allow teams to predict each other's actions and improve coordination (Srikanth and Puranam 2011). Underscoring the importance of this strategy, the PCAOB (2016, 18) notes situations in which component auditor personnel “lacked the necessary industry experience or knowledge of PCAOB and SEC rules and standards ... and the applicable financial reporting framework to perform the work requested by the lead auditor.”

We investigate several specific ways in which firms can improve tacit coordination. Walther (1997) notes that because information and knowledge transfer are slower in geographically distributed work, better outcomes are achieved when groups have long-term membership. Thus, staffing distributed teams with individuals who previously worked together could improve understanding of actions and coordination of work in the global group audit, leading to increased predictability of action between group and component auditors. This implies that longer audit partner and manager tenure on the engagement, as well more prior joint work by group and component auditors, could mitigate the effects of complexity.

While seasoned group and component audit team members are likely to have more shared engagement-specific knowledge to leverage, prior research emphasizes that knowledge of contextual features is also important (Sole and Edmondson 2002). The U.S. regulatory environment, as well as GAAP, GAAS, and industry standards, are key features of the context in which the group auditor operates. A greater understanding of these features should assist component auditors to appropriately apply information communicated, increasing predictability of action from the perspective of the group auditor. Training focused on cultural differences also might aid teams in building common understanding of contextual features that could be leveraged (Srikanth 2007; Srikanth and Puranam 2011).

Another mechanism to obtain a greater mutual understanding is temporary assignment of the component auditor to the U.S. firm (i.e., a secondment), or the group auditor to the local firm (i.e., expatriate). Such experience provides the opportunity for direct observation, contextual cues, and questioning, all of which could reduce challenges for geographically distributed teams by enabling effective knowledge sharing (Straus and Olivera 2000; Sole and Edmondson 2002; Mäkelä 2007). Further, to ease communication difficulty and reduce the effects of complexity, distributed team members (in our context, the component and group engagement teams) should help each other to understand the remote decision-making process, making local contextual features explicit (Srikanth and Puranam 2011).

Modularization

Theory and empirical results from the management literature suggest that a second strategy to alleviate the effects of complexity in global group audits is to “modularize” activities in advance, so as to minimize interdependence during the actual performance of work (Sanchez and Mahoney 1996; MacDuffie 2007). Modularization allows for coordination of actions between team members “by simply adhering to an operating procedure that specifies what each must do individually so that their joint actions are coordinated,” thus potentially reducing coordination complexity (Srikanth and Puranam 2011, 853). While research supports a possible effect of modularization in global group audits, this strategy has only been tested for well-defined business activities such as mortgage processing, in which the “architecture” of the process (Srikanth and Puranam 2011, 854) is well understood. Extension of these results to the more complex and fluid context of auditing is an empirical question.¹⁰

In the context of global group audits, modularization strategies imply tailoring component audit instructions and organizing local fieldwork so that it can be performed without reliance on group auditors, as well as developing standardized plans or procedures for future interactions. Additionally, to minimize interdependencies the group auditor may elect to have the component auditor scope the work to be

¹⁰ Unlike more static contexts, findings from initial audit procedures can alter requirements for subsequent testing and follow-up. The iterative nature of auditing, whereby the audit plan is continually revised to address new information discovered during risk assessment and internal controls testing, may make modularization more difficult and ultimately less successful than in previously tested environments that are more predictable.

performed over the component, i.e., design/determine the type of work.¹¹ Tasking the component auditor with the scoping of the work to be performed may further separate the component audit work from the group audit work. In so doing, the component auditor might improve efficiencies between the group audit and local statutory requirements. However, successful integration of modularized work at the conclusion of the audit requires compliance by the component auditor with the instructions or plan laid out by the group auditor. It seems that such advance scripting of work might be more successful in large global network firms, as their public pronouncements and prior research suggest that work practices and knowledge management are distributed through their networks (e.g., Carson 2009; Dowling 2009). However, there is tension in this question, as other research suggests variation in the application of firm practices across global networks (e.g., Barrett et al. 2005; Saito and Takeda 2014). Additionally, some evidence suggests that before the advent of PCAOB oversight, component auditors exercised considerable discretion in executing instructions from the group team (Barrett et al. 2005). Whether local “appropriation” of modularization efforts persists in the current, more highly regulated context, is unknown.

Ongoing Communication

The third strategy that may mitigate effects of complexity on a global group audit is ongoing communication. Prior research indicates that the content, method, and ease of communication between distributed team members provide opportunities to facilitate predictability and coordination in geographically distributed work (Srikanth and Puranam 2011). The content of communication between the group and component auditors is driven in part by audit regulations (i.e., ISA 600), which require the group auditor to communicate the work to be performed, including the risks to be addressed, the purpose of such work to the group audit team, and information to be reported upon completion of the audit (IFAC 2007). The group auditor may either include the component auditor in meetings on such topics (e.g., an

¹¹ The scope of the audit refers to designing/determining the type of work to be performed. The group auditor may elect to design/determine the type of work to be performed over the component, or have the component auditor design/determine the type of work on the group auditor’s behalf (IFAC 2007).

engagement kickoff meeting, discussion of instructions, or fraud brainstorming), or communicate results of the meeting to the component auditor after the fact.

Prior literature also shows that face-to-face communication allows for a greater number of information cues to be communicated and observed, reducing the effects of complexity by promoting a mutual understanding between team members (Hinds and Mortensen 2005). In the audit studied by Barrett et al. (2005), on-site visits were important to both group and component auditors. However, due to cost and time constraints, on-site visits are likely to be sporadic. Absent face-to-face communication, employing synchronous communication methods (e.g., telephone or web conferencing) could help reduce the effects of complexity relative to asynchronous communication methods such as email (Montoya-Weiss, Massey, and Song 2001; Cummings, Espinosa, and Pickering 2009). Synchronous communication methods provide a conversational flow to organize information, allowing immediate feedback.

To assist teams in navigating the nuances of coordinating and communicating across geographic boundaries, the management literature advocates providing guidance on how to work remotely (Weisband 2002). Additionally, research argues that actually seeing another team member's work can promote a shared understanding and contribute to successful coordination (Karsenty 1999; Fussell, Kraut, and Siegel 2000; Gutwin, Penner, and Schneider 2004), although limitations on audit workpaper sharing prohibit direct observation in some jurisdictions. Srikanth and Puranam (2011) suggest that investing in technologies to facilitate remote collaboration and employing electronic tools to share work in process can increase reciprocal predictability of action, and thus reduce communication challenges.

The literature also suggests that ease of communication between distributed team members impacts the overall success of geographically distributed work arrangements (Srikanth and Puranam 2011). For instance, distributed team members should engage in frequent and spontaneous communication to improve reciprocal predictability of action, easing communication difficulty (Hinds and Mortensen 2005; Srikanth and Puranam 2011). Achieving a congruent understanding when team members possess different views and expectations also requires free exchange of information (Vlaar et al.

2008). While the PCAOB (2016) reports that some audit firms are focusing on improving communication with component auditors, significant deficiencies continue to be identified.

Summary

The management literature proposes three strategies that could improve coordination and communication in the global group audit by mitigating the influence of complexity in interdependent work. As previously noted, it is uncertain whether previous findings in simpler contexts will generalize to the context of auditing. We propose the following hypothesis:

H2: Tacit coordination, modularization, and ongoing communication strategies are negatively associated with coordination and communication challenges experienced in global group audits.

H1 and H2 propose main effects of complexity (positive) and strategies (negative) on challenges experienced in global group audits. However, instead of an overall effect, it may be that a given strategy is only effective with a particular source of complexity, or at a particular level of complexity (high or low). Prior research does not provide guidance at this level of specificity, yet it is important for both auditing research and audit practice to understand the nuances of factors affecting the relative difficulty of managing global group audits. We propose the following research question to guide our exploratory analysis regarding these possibilities:

R1: Which coordination and communication strategies reduce the effects of specific sources of complexity on challenges experienced in global group audits?

IV. METHOD

Data and Participants

To investigate global group audits, we used an experiential questionnaire to solicit information from highly experienced audit professionals on engagements in which they, as members of the group engagement team, relied on auditors at foreign locations to perform audit work over components of the consolidated financial statements of a U.S.-based entity. The Center for Audit Quality distributed two versions of the questionnaire to senior managers with multiple global group audit experiences. One asks participants to recall an engagement where they encountered significant challenges, while the other asks

about an engagement in which any challenges encountered were of little significance.¹² Within the selected engagements, the questionnaire asks participants to focus on a single component that best represents the level of challenges experienced. This design follows previous studies in auditing that employ a retrospective approach, by focusing on specific engagement experiences and avoiding “leading” questions to promote accurate recall and reporting (e.g., Gibbins, Salterio, and Webb 2001; Nelson, Elliott, and Tarpley 2002; Rennie, Kopp and Lemon 2014; Cannon and Bedard 2016).¹³

From multiple participating Big 4 firms, 151 senior managers provided data on 190 global group audit experiences, of which 149 observations have complete data on variables used in our analyses.¹⁴ We remove two observations for which the component auditor is not a member of the same global network as the group auditor.¹⁵ Of those, 74 (50.3 percent) are challenging and 73 (49.7 percent) are non-challenging. The majority of experiences (68.0 percent) occurred less than a year prior to the time of response, while 16.3 percent occurred between one and two years prior. The recency of sample experiences should improve recall of engagement circumstances. On average, the global group audits involve about nine components, ranging from one to 54 components. Eighty-six percent of clients in the sample are SEC registrants, in the manufacturing (30.6 percent), technology (21.8 percent), retail (7.5 percent), consumer products (6.8 percent), financial services (6.1 percent), and energy/utilities (6.1 percent) industries. Forty-

¹² Data provided through the CAQ and participating firms indicate that 74.51 percent of the auditors solicited for the study completed the questionnaire, and that response rates do not differ between versions of the questionnaire.

¹³ This design follows the precepts of the Critical Incident Technique, originated by Flanagan (1954), and used extensively in industrial and organizational psychology and other business disciplines. In focusing on highly salient experiences, extensive prior research shows that the Critical Incident Technique leads to more accurate recalls.

¹⁴ About 85 percent of the 151 participants were senior managers at the time of the global group audit experience, while 14.8 percent were managers at that time. Participants described one or two global group audit experiences based on the preference of their firm; 72.2 percent described a single experience, and the remaining 27.8 percent described both a challenging and a non-challenging experience. Firms preferring to have participants describe two global group audit experiences randomly distributed two versions of the questionnaire to mitigate any order effects: one that first requests information on a challenging engagement and, another that first requests information on a non-challenging engagement. We omit responses of one individual who responded to the “challenging” version, but noted in an open-ended response that (s)he had no challenging engagements to supply. To ensure anonymity, no identifying information was collected, including identity of the group auditor’s firm.

¹⁵ While comparing within-network to out-of-network global group audits is interesting and important, the few out-of-network component auditors in our sample prevent that comparison. In contrast, Carson et al. (2016) report 19 percent of group audits led by Australian teams involve component auditors that are all within-network. One factor contributing to this difference is our focus on Big 4 firms, which are more likely than smaller firms to have network affiliates located where components are domiciled.

one percent have consolidated annual revenues of greater than \$5 billion, 35.4 percent between \$1 and \$5 billion, 15.0 percent between \$200 million and \$1 billion, 4.8 percent between \$25 and \$200 million, and 3.4 percent have consolidated annual revenues of \$25 million or less.

Questionnaire Design and Collection Procedures

To develop the instrument, we conducted a series of interviews with senior managers from several of the participating firms, and solicited additional feedback from audit partners. The final questionnaire reflects the feedback of these professionals, the literature on geographically distributed work, and ISA 600. In selecting a global group audit experience, the questionnaire instructs participants to choose a continuing audit (not a first year audit), where the work performed by the component auditor was fairly extensive. Following this general prompt, the questionnaire asks them to choose an engagement for which they are familiar with how their team coordinated and communicated with the component auditors, and how the component engagement teams' work was integrated into the overall audit. Within the selected engagement, the questionnaire asks participants to focus responses on a single component that best represents the engagement's challenging or non-challenging nature, respectively. In the "challenging" version, the questionnaire focuses the study's purpose by instructing participants to choose an engagement where significant coordination and communication challenges were encountered, exemplifying at least one of several broad types derived from concerns of the PCAOB and the firms providing data. These include difficulties related to the execution of the component audit work, variation in the risk assessed or the quality work performed by the component auditor, and issues of timeliness.¹⁶

To provide ample time to consider the criteria, choose a relevant engagement, and consider the details of that experience through recall or search of workpapers, a firm liaison sent a letter on our behalf to each participant several days in advance of sending the questionnaire, explaining the study. Both the

¹⁶ Results of preliminary verbal protocols and pretests demonstrated that providing a list was necessary to gather experiences related to coordination and communication problems, the scope of this study. The challenge types were developed with advice from partners at the firms providing data to cover non-industry-specific issues addressed in ISA 600, and cover key aspects of audit quality.

letter and the questionnaire assured participants of anonymity, asking for responses to be as specific as possible without including information that might identify the client, the firm, or the participant.

Variables

In order to investigate sources of complexity distinguishing challenging global group audits, and whether the use of specific strategies mitigates the effects of complexity, we develop test variables using polychoric factor analysis within the theoretically derived categories of complexity and mitigating strategies. Below we first present the underlying variables by category, and subsequently describe the development of the factors used for empirical tests.

Complexity

Table 1 Panel A contains measures of *complexity* present in a global group audit. To measure company complexity features, we include *REVENUE* (measured in broad categories from 1 (" \leq \$25 million") to 5 (" $>$ \$5 billion") to ensure anonymity of clients), an indicator for *SEC_REGISTRANT*, and *NUMBER_COMPONENTS*. Measures of the nature of the component audit work arising from company characteristics include an indicator for the component auditors' responsibility for the local *STATUTORY_AUDIT*, and the group auditor's perception of the component auditor's *WORK_COMPLEXITY*, measured on a scale ranging from 1 ("Very Low") to 11 ("Very High"). Measures of organizational structure include *SUPERV_COMPONENT* (equal to 1 if the component has a number of sub-components under its supervision; 0 otherwise), *SUB_COMPONENT* (equal to 1 if the component reports indirectly to the group auditor through another component engagement team; 0 otherwise), and *OTHER_TEAM* (a team other than the component auditor performs a portion of the work; 0 otherwise).¹⁷ Complexity may also be introduced into the global group audit through language/cultural differences between the group and component auditor. *LANG_BARRIERS* and *CULTURAL_BARRIERS* are measured on scales ranging from 0 ("Not At All") to 11 ("Very High").

Insert Table 1 About Here

¹⁷ For example, the auditor of a shared service center may test receivables for the entire region or centralized IT specialists may test general controls over the ERP system. In both instances a portion of the component audit work is performed by an auditor other than the component engagement team.

Tacit Coordination

Table 1 Panel B shows variables comprising the *tacit coordination* strategy. Measures relating to component auditors include *CA_MGR_EXPERIENCE* and *CA_PTR_EXPERIENCE*, (the number of years the component audit leaders worked on the engagement). The stability of component audit staff, *CA_STABILITY*, equals 1 if the component audit staff did not turn over from prior periods; 0 otherwise. Exposure to the U.S. audit environment is measured by *CA_US_TOUR* (which equals 1 if a member of the component audit team had worked in the U.S. in the last five years; 0 otherwise) and *CA_US_EXPAT* (equaling 1 if the component audit team included a member of the U.S. firm working abroad; 0 otherwise). The extent of the component auditors' knowledge of U.S. regulations and the industry is measured by *CA_KNOW_GAAP*, *CA_KNOW_GAAS*, *CA_KNOW_REG_ENV*, and *CA_KNOW_INDUSTRY*, using scales ranging from 1 = "Very Low" to 11 = "Very High". Tacit coordination variables relating to group auditors include *GA_MGR_EXPERIENCE* and *GA_PTR_EXPERIENCE*. Further, we include an indicator for group audit team training on cultural differences (*CULTURAL_TRAINING*). We also measure past interactions through which group and component auditors could have shared knowledge on prior engagements (*WORK_TOGETHER_PRIOR*, measured on a scale ranging from 0 = "Not at All" to 11 = "Very High"). Finally, *DECISIONS_EXPLAINED* captures the extent to which group auditors made their reasoning processes explicit to the component team in the current engagement (measured on a scale ranging from 0 = "Not at All" to 11 = "Very High").

Modularization

Table 1 Panel C presents variables representing the coordination strategy of *modularization*, which involves reducing interdependencies and standardizing interactions between group and component auditors. Category variables *TAILORED_INSTRUCTIONS*, *TAILORED_WORK* and *PLANNED_INTERACTIONS* measure the extent to which the group auditor reduced interdependencies and standardized interactions through audit planning activities (measured on a scale ranging from 0 = "Not at

All” to 11 = “Very High”). We also include *CA_SCOPED*, an indicator for whether or not the component auditors scoped the component audit procedures.

Ongoing Communication

Table 1 Panel D contains variables representing the *ongoing communication* strategy, which focuses on communication content, method, and ease of communication. Measures of communication content include indicators for direct involvement of the component auditor in the *KICKOFF_MEETING*, *INSTRUCTIONS_DISCUSSION* and *FRAUD_BRAINSTORMING*. We measure the extent to which firms provide guidance and tools to assist global group auditors in overcoming the challenges introduced by working across geographic boundaries using *GUIDANCE_WORK_REMOTELY*, *TECHNOLOGY_AVAILABLE*, and *ELECTRONIC_TOOLS_USE*, respectively (each measured on a scale ranging from 0 = “Not at All” to 11 = “Very High”). We measure ease of communication through *COMMUNICATION_FREQ* (the average number of times per week the group and component auditor communicated), as well as *COMMUNICATION_SPONT* and *FREE_EXCHANGE* (measured on a scale ranging from 0 = “Not at All” to 11 = “Very High”). Additionally, we measure *SYNCHRONOUS_VALUED*, *SYNCHRONOUS_FREQ* and *ONSITE_VISIT*, which are indicators for whether the most valued (frequently used) communication method was synchronous and whether the group audit leader(s) visited the component audit location.

Control Variables

Table 1 Panel E defines a control variable for significance of changes occurring during the audit (*AUDITPLAN_CHANGE*) measured on a scale from 0 (“Not at All”) to 11 (“Very High”).¹⁸ We also include industry indicators in the models, but do not table these variables.

Factor Analysis

Our theoretical constructs of complexity and mitigating strategies each contain multiple variables derived from prior research and input from participating firms. As many of these individual variables are

¹⁸ We also measured *CLIENTBUS_CHANGE*, the number of changes in the company’s and/or the component’s business during the audit period (e.g., financial health, mergers/acquisitions, management turnover, and system implementation). This variable is not significant in any of the models, and so is not included for parsimony.

correlated data reduction is needed prior to estimating models.¹⁹ Due to the primarily binary and ordered categorical nature of the measures, we use polychoric factor analysis with varimax rotation within the constructs to develop parsimonious measures of the latent constructs (e.g., Drasgow 1988; Dorantes, Chan, Peters, and Richardson 2013; Harris, Petrovits, and Yetman 2015). The Appendix presents results of factor analysis, including factor loadings. Table 2 provides variable names and interpretations of the resulting factors, the percent of variance explained by each factor, and correlations among them.

Insert Table 2 About Here

Complexity

Table 2 first describes the factors derived from polychoric factor analysis of complexity variables. Three factors have eigenvalues greater than 1.0, together explaining 78.1 percent of the variance of the original measures. Using factor loadings of at least 0.40, we interpret these factors as *COMPLEXITY_SIZE* (23.5 percent of variance explained), *COMPLEXITY_STRUCTURE* (24.4 percent), and *COMPLEXITY_BARRIERS* (30.2 percent), consistent with prior research cited above. Variables loading positively on *COMPLEXITY_SIZE* include client revenues and SEC registrant status. With respect to *COMPLEXITY_STRUCTURE*, variables loading positively include the component auditor performing a statutory audit and number of components involved in the engagement. For *COMPLEXITY_BARRIERS*, the extent of language and cultural barriers load positively, while sub-component structure loads negatively. The signs of these loadings imply that language/cultural barriers occur less often when the component reports to the group auditor through an additional layer (e.g., a component in Italy reports through a European supervisory team; see Figure 2).

Tacit Coordination

Table 2 next shows five factors relating to tacit coordination measures with eigenvalues over 1.0, explaining 70.6 percent of the variance of the original measures. Variables loading positively on *TACIT_CA_EXPERIENCE* (12.3 percent of variance explained) include engagement experience of the

¹⁹ For instance, significantly correlated variables include: *LANG_BARRIERS* and *CULTURAL_BARRIERS* (0.67); *CA_KNOW_GAAP* and *CA_KNOW_GAAS* (0.86); *TAILORED_INSTRUCTIONS* and *TAILORED_WORK* (0.58); and *TECHNOLOGY_AVAILABLE* and *ELECTRONIC_TOOLS_USE* (0.54).

component audit manager and the extent to which group and component auditors have previously worked together. For *TACIT_CA_STABILITY* (11.1 percent), the extent to which the component team did not change from the prior year loads positively. For *TACIT_CA_EXPAT* (10.0 percent), a U.S. expatriate on the component auditor team loads positively. With respect to *TACIT_CA_KNOWLEDGE* (25.4 percent), variables loading positively include extent of the component auditor's knowledge of U.S. GAAP, GAAS, regulatory environment and industry. For *TACIT_GA_EXPERIENCE* (11.8 percent) group partner experience loads positively, while cultural training loads negatively.²⁰ The opposing signs within this factor suggest that cultural training is more often used by less experienced group partners, although the overall mean of cultural training is low (4.1 percent).

Modularization

Table 2 next shows that factor analysis of modularization variables yields one factor with an eigenvalue over 1.0, explaining 93.8 percent of the variance of the original measures. The extent to which tailored instructions, tailored work, and planned interactions are used within the engagement to minimize interdependencies all load positively on *MODULARIZATION*.

Ongoing Communication

Factor analysis of ongoing communication measures yields three factors with eigenvalues over 1.0, explaining 79.9 percent of the variance of the original measures. We identify these factors as *ONGOING_CONTENT* (35.4 percent of variance explained), *ONGOING_ELECTRONIC* (25.5 percent), and *ONGOING_FTF* (19.0 percent). Variables loading positively on *ONGOING_CONTENT* include the extent to which the group auditor involves the component auditor in the kickoff meeting, discussion of instructions, and fraud brainstorming; and when the communication method most valued is synchronous. Variables loading positively on *ONGOING_ELECTRONIC* include the extent to which the group team received guidance in how to work remotely with component auditors, and the availability and use of

²⁰ Cultural training also loads negatively on *TACIT_CA_EXPERIENCE*. This suggests that group auditors are more likely to receive cultural training when component auditors are less experienced.

electronic tools on the engagement. For *ONGOING_FTF*, the extent of use of synchronous communication methods and extent of face-to-face meetings between teams load positively.

Models

To summarize, we measure three sources of complexity and three mitigating strategies, deriving variables representing each construct from the factor analyses presented above.²¹ Model 1 is a preliminary main effects probit model, testing overall associations of complexity and strategy variables with the probability that an engagement is identified as a highly challenging global group audit.

$$\begin{aligned} CHALLENGING = & \beta_0 + \beta_1 COMPLEXITY_SIZE + \beta_2 COMPLEXITY_STRUCTURE & (1) \\ & + \beta_3 COMPLEXITY_BARRIERS + \beta_4 TACIT_CA_EXPERIENCE + \beta_5 TACIT_CA_STABILITY \\ & + \beta_6 TACIT_CA_EXPAT + \beta_7 TACIT_CA_KNOWLEDGE + \beta_8 TACIT_GA_EXPERIENCE \\ & + \beta_9 MODULARIZATION + \beta_{10} ONGOING_CONTENT + \beta_{11} ONGOING_ELECTRONIC \\ & + \beta_{12} ONGOING_FTF + \{Control Variables\} + \varepsilon \end{aligned}$$

Models 2-4 are interaction models, testing whether the mitigating effect of each strategy varies by source of complexity. A significant coefficient on the interaction between a specific strategy and a particular source of complexity implies that the effect of a given source of complexity on engagement challenges varies according to the level of specific strategies used. We estimate a separate model for each source of complexity: in Model 2 [*complexity*] is measured as *COMPLEXITY_SIZE*, in Model 3 as *COMPLEXITY_STRUCTURE*; and in Model 4 as *COMPLEXITY_BARRIERS*.²² In each model, the source of complexity of interest is interacted with each strategy, and other sources of complexity are retained as main effects.

$$\begin{aligned} CHALLENGING = & \beta_0 + \beta_1 COMPLEXITY_SIZE + \beta_2 COMPLEXITY_STRUCTURE & (2)-(4) \\ & + \beta_3 COMPLEXITY_BARRIERS + \beta_4 TACIT_CA_EXPERIENCE + \beta_5 [complexity]*CAEXP \\ & + \beta_6 TACIT_CA_STABILITY + \beta_7 [complexity]*STABILITY + \beta_8 TACIT_CA_EXPAT \\ & + \beta_9 [complexity]*EXPAT + \beta_{10} TACIT_CA_KNOWLEDGE + \beta_{11} [complexity]*KNOWL \\ & + \beta_{12} TACIT_GA_EXPERIENCE + \beta_{13} [complexity]*GAEXP + \beta_{14} MODULARIZATION \\ & + \beta_{15} [complexity]*MODULAR + \beta_{16} ONGOING_CONTENT + \beta_{17} [complexity]*CONTENT \\ & + \beta_{18} ONGOING_ELECTRONIC + \beta_{19} [complexity]*ELECTRONIC + \beta_{20} ONGOING_FTF \\ & + \beta_{21} [complexity]*FTF + \{Control Variables\} + \varepsilon \end{aligned}$$

V. RESULTS

²¹ All models include control variables for the auditor's judgment of the extent of changes in the audit (*AUDITPLAN_CHANGE*) and the client industry. The models are estimated using robust standard errors clustered on participant.

²² Results do not differ qualitatively if all sources of complexity are tested in one model.

Descriptive Statistics

Information About the Nature of Significantly Challenging Global Group Audits

Prior to discussing our main results, we present descriptive information on the importance and breadth of challenges experienced by participants in the components selected as having significant challenges, the extent to which those challenges were anticipated, and specific challenges encountered. Table 3 Panel A shows that the challenges experienced on the selected components were rated as more than moderately important to the overall global group audit (mean = 7.0). On average, nearly a third of all components on sample engagements possess significant challenges (29.6 percent), and the challenges were moderately anticipated (mean = 5.6).²³ Table 3 Panel B shows that challenges often relate to *execution* of audit work, including *OBTAINING_CLARITY* (52.7 percent), *COMMUNICATING_COORDINATING* (52.7 percent), *ADDITIONAL_PROCEDURES* (33.7 percent), and *INVOLVING_GA* (25.7 percent). In 12.2 percent of engagements, challenges involve variation in risks assessed by the component and group auditors. In 31.1 percent, group auditors report that the work performed by the component auditors does not always comply with instructions. Table 3 also highlights the prevalence of *timing* challenges in global group audits: *NONTIMELY_COMMUNICATION* and *NONTIMELY_COMPLETION* are common (41.9 and 58.1 percent, respectively), but *SUBSEQUENT_DISCOVERY* is rare (6.8 percent).

Insert Table 3 About Here

Sources of Complexity and Mitigating Strategies

Table 1 presents descriptive statistics for responses to all questions submitted to factor analysis and control variables. Table 1 shows means (standard deviations) for continuous and scale variables, or the percent equal to 1 for indicators, for the entire sample, as well as univariate tests of differences between subsamples of challenging and non-challenging experiences. For efficiency of presentation, we highlight certain interesting overall trends in the data, but do not discuss univariate comparisons.

²³ Interestingly, the proportion of components possessing significant challenges in our sample is comparable to rate of audit failures identified by the PCAOB during 2013 for “referred work” inspections (Munter 2014).

Complexity. Table 1 Panel A describes measures of *complexity* inherent in the global group audit. Most sample entities are very large (averaging 4.1 on the 5-point scale of annual revenues), 86.4 percent are SEC registrants, and they average 8.9 components. In 87.1 percent of experiences, the component auditor also performs a *STATUTORY_AUDIT*. Group auditors on average judge the component auditor's work to be moderately complex (6.3 on the 11-point scale).

Tacit Coordination. Table 1 Panel B describes measures related to the *tacit coordination* strategy (i.e., leveraging experience and knowledge), first presenting variables related to component auditors, then group auditors, and then interactions between them. Mean *CA_MGR_EXPERIENCE* is 8.0 years, nearly twice that of *GA_MGR_EXPERIENCE* (4.2 years), while means of *CA_PTR_EXPERIENCE* (3.6 years) and *GA_PTR_EXPERIENCE* (3.5 years) are lower, consistent with SEC limits on partner tenure. About 21 (19.7) percent of component engagement teams have a *CA_US_TOUR* (*CA_US_EXPAT*). *CULTURAL_TRAINING* for group auditors, which might provide knowledge of key contextual features, is rare (4.1 percent). Component auditor knowledge of US GAAP, GAAS, regulation and the relevant industry are rated on average moderately high (7.2 to 9.0).

Modularization. Table 1 Panel C describes measures related to the *modularization* strategy. Descriptive statistics indicate that group auditors regularly employ *TAILORED_INSTRUCTIONS* (7.9), *TAILORED_WORK* (7.0), and *PLANNED_INTERACTIONS* (8.4) as coordination strategies. Component auditors scope relatively few sample engagements (10.9 percent; *CA_SCOPED*).

Ongoing Communication. Table 1 Panel D describes measures related to the *ongoing communication* strategy. Component auditors frequently participate in meetings for engagement kickoff, communication of instructions, and fraud brainstorming (54.4 to 79.6 percent). The extent of *TECHNOLOGIES_AVAILABLE* to facilitate remote communication is moderate (5.1) and *ELECTRONIC_TOOLS_USE* is fairly low (4.2). Thus, although technologies and electronic tools are often considered to be common across global networks, our participants do not rate them as extensively available or employed in the global group audit context. Group and component auditors communicate on average 1.8 times per week. Synchronous communication methods are highly valued

(*SYNCHRONOUS_VALUED*, 73.5 percent) relative to the infrequent use of those methods (*SYNCHRONOUS_FREQ*, 10.9 percent). This suggests a tendency to use communication methods with fewer information cues, despite the recognized value of richer communication methods.

Results of Multivariate Models

As a preliminary analysis, we first estimate Model 1, a main effects probit model of *CHALLENGING* with complexity and strategy factors. Results in Table 4 Column A show that both *COMPLEXITY_STRUCTURE* and *COMPLEXITY_SIZE* have the expected positive signs ($p < 0.10$ and 0.05 , respectively). The only strategies significantly associated with lower probability of a challenging engagement are tacit coordination factors related to component auditors: *TACIT_CA_EXPERIENCE*, *TACIT_CA_STABILITY*, and *TACIT_CA_KNOWLEDGE* (all at $p < 0.01$). Main effects model results thus suggest that across the sample, engagements identified as challenging tend to be performed on clients that are large SEC registrants with a greater number of components and statutory audit requirements in the component countries. Further, this analysis suggests that the only strategy effective in reducing the overall probability of challenges is the consistent employment of an experienced, knowledgeable component auditor team. Main effects findings do not show that language and cultural barriers increase the challenges experienced in global group audits overall, or that some strategies employed by the profession mitigate challenges (including modularization of work, increasing interaction between teams through meetings, or availability/use of electronic tools). However, this model presents a simplistic picture, as some strategies may be effective only for specific sources or levels of complexity, i.e., higher or lower.

Insert Table 4 About Here

Models 2-4 build on Model 1 by adding interactions of complexity and strategy factors, testing whether the effects of strategies are contingent on the levels and types of complexity characteristics of the sample global group audits.²⁴ Model 2 interacts the three strategies (tacit coordination, modularization,

²⁴ Models 2-4 have Pseudo-R² values ranging from 0.21 to 0.28, and ROC areas of 0.80 to 0.83, indicating excellent discrimination (Hosmer and Lemeshow 2000). Table 2 presents Pearson correlations among factors. While a few correlations are significant ($p < 0.05$, two-tailed), the highest values are -0.41 (*TACIT_CA_EXPERIENCE* and

and ongoing communication) with *COMPLEXITY_SIZE*, Model 3 with *COMPLEXITY_STRUCTURE*, and Model 4 with *COMPLEXITY_BARRIERS*.²⁵ Table 4 presents the results of these models in Columns B-D, and Figure 4 graphs predicted probabilities for significant interactions at the mean and one standard deviation above/below the mean (which we describe in the text as “higher/lower” values of the factors), with other variables held at their means.

Insert Figure 4 About Here

Interactions of Strategies with Complexity Related to Company Size/Regulatory Status

Table 4 Column B shows results of Model 2, interacting strategy use with *COMPLEXITY_SIZE* (higher revenues and SEC registrant status). Main effects for *TACIT_CA_EXPERIENCE*, *TACIT_CA_STABILITY*, and *TACIT_CA_KNOWLEDGE* remain negative and significant in the presence of the interaction terms ($p < 0.01$). The insignificant interaction with *TACIT_CA_KNOWLEDGE* implies that greater component auditor knowledge of US GAAS, GAAP and industry norms reduces challenges across the range of *COMPLEXITY_SIZE*. However, significant interactions with *TACIT_CA_EXPERIENCE* and *TACIT_CA_STABILITY* show that effects of these strategies are contingent on company size. Specifically, *COMPLEXITY_SIZE*CAEXP* is negative and significant ($p < 0.05$), implying that component auditor experience has a greater mitigating effect on challenges as size increases. Figure 4 Panel A shows that for higher *COMPLEXITY_SIZE*, the predicted probability is 0.33 (0.76) for higher (lower) *TACIT_CA_EXPERIENCE*. For lower *COMPLEXITY_SIZE*, the predicted probability of a challenging audit does not differ. In contrast, *COMPLEXITY_SIZE*STABILITY* is positive and marginally significant ($p < 0.10$), implying that lack of turnover in component auditor staff mitigates challenges as size complexity decreases. Figure 4 Panel B confirms this pattern. For higher *COMPLEXITY_SIZE*, the predicted probability does not differ, but for lower *COMPLEXITY_SIZE* the predicted probability is 0.30 (0.77) for higher (lower) *TACIT_CA_STABILITY*.

TACIT_CA_STABILITY) and 0.22 (*COMPLEXITY_SIZE* and *ONGOING_ELECTRONIC*). Variance inflation statistics in all models are low (the largest is 3.00), indicating that multicollinearity is not a concern.

²⁵ Industry control variables (untabed) consistently show that the financial services industry is less often represented in challenging engagements, consistent with greater regulation in that industry.

Table 4 Column B shows that *COMPLEXITY_SIZE*EXPAT* is negative and significant ($p<0.01$), with a disordinal pattern illustrated in Figure 4 Panel C. For higher *COMPLEXITY_SIZE*, including a U.S. expatriate is associated with a lower predicted probability of a challenging audit: 0.40 (0.69) for higher (lower) *TACIT_CA_EXPAT*. For lower *COMPLEXITY_SIZE*, the predicted probability of a challenging audit is 0.73 (0.32) for higher (lower) inclusion of a U.S. expatriate on the component audit team.²⁶ Model 2 results also show that *COMPLEXITY_SIZE*MODULAR* is positive and significant ($p<0.05$), illustrated in Figure 4 Panel D. For higher *COMPLEXITY_SIZE*, the predicted probability of a challenging audit is 0.62 (0.47) when *MODULARIZATION* is higher (lower). For lower *COMPLEXITY_SIZE*, modularization reduces challenges, as the predicted probability of a challenging audit is 0.32 (0.67) for higher (lower) modularization.

Taken together, results for Model 2 imply that greater component auditor knowledge is uniformly associated with lower probability of challenging group audits, regardless of company size. When company size is higher, both engagement experience of component audit team leaders and expatriate experience on the component team help mitigate challenges, and by that standard are highly useful. However, merely having a stable component staff only mitigates challenges when size complexity is lower. Results further show that modularization only mitigates challenges when size complexity is low, and may be counterproductive when size complexity is high. Model 2 shows no impact of ongoing communication strategies on mitigating challenges associated with company size.

Interactions of Strategies with Structural Complexity

Table 4 Column C presents results of Model 3, with interactions based on complexity measured as client structure (i.e., number of global components of the entity, and statutory audit requirements of the selected component). Model results show that *COMPLEXITY_STRUCTURE* is positive and significant ($p<0.01$). This effect must be interpreted in light of significant interactions discussed below. *TACIT_CA_EXPERIENCE*, *TACIT_CA_STABILITY*, and *TACIT_CA_KNOWLEDGE* are all negative and

²⁶ This effect should be interpreted with caution due to relatively fewer expatriates involved on engagements on small, private companies. Only three expats were involved on engagements below the mean of *COMPLEXITY_SIZE*, while 26 were involved were involved on engagements above the mean.

significant ($p < 0.01$) and their associated interactions are insignificant, implying that longer component auditor engagement experience, stability of component audit staff year-over-year, and greater component auditor knowledge are associated with lower probability of challenges overall.

Turning to the interaction terms in Model 3, we find that *COMPLEXITY_STRUCTURE* **MODULAR* is negative and significant ($p < 0.05$). Figure 4 Panel E shows that for higher *COMPLEXITY_STRUCTURE*, the predicted probability of a challenging audit is 0.45 (0.82) for higher (lower) modularization, while for lower *COMPLEXITY_STRUCTURE* this order reverses ((0.49 (0.18) for higher (lower) modularization). The interaction with *ONGOING_CONTENT* is also negative and significant ($p < 0.05$) in Model 3. As this interaction is similar in shape to Figure 4 Panel E, it is not graphed. For higher *COMPLEXITY_STRUCTURE*, predicted probabilities of a challenging audit are 0.49 (0.77) for higher (lower) component auditor involvement in meetings. However, for lower *COMPLEXITY_STRUCTURE*, the predicted probabilities of a challenging audit are 0.52 (0.16) for higher (lower) component auditor involvement.

Taken together, results of Model 3 imply that structural complexity is strongly associated with challenging global group audits. An experienced, stable and knowledgeable component team helps mitigate its effects, as the impact of these strategies holds across the range of structural complexity. In addition, the two significant interaction terms (with *MODULARIZATION* and *ONGOING_CONTENT*) in Model 3 exhibit a common pattern. For both strategies, our results imply similar effectiveness in mitigating coordination and communication problems for components with higher vs. lower structural complexity. However, the opportunity cost of *not* engaging in these strategies is evident from the striking increase in probability of a challenging audit for lower strategy use as structural complexity rises.

Interactions of Strategies with Complexity Due to Language/Cultural Barriers

Table 4 Column D shows results of Model 4, which interacts strategies with *COMPLEXITY_BARRIERS* (complexity measured as language and/or cultural barriers). Results show that *TACIT_CA_EXPERIENCE*, *TACIT_CA_STABILITY*, and *TACIT_CA_KNOWLEDGE* are negative and significant ($p < 0.01$, $p < 0.05$ and $p < 0.01$, respectively), implying that greater component auditor manager

experience, staff stability, and component auditor knowledge are associated with lower probability of a challenging engagement overall. Both *COMPLEXITY_BARRIERS*CONTENT* and *COMPLEXITY_BARRIERS*ELECTRONIC* are negative and significant ($p < 0.10$ and $p < 0.05$, respectively), with patterns similar to Figure 4 Panel C. For higher *COMPLEXITY_BARRIERS*, predicted probabilities of a challenging audit are 0.48 (0.57) for higher (lower) component auditor involvement in engagement kick-off, discussion of instructions, and fraud brainstorming (*ONGOING_CONTENT*). For lower *COMPLEXITY_BARRIERS*, this order reverses, and involvement of component auditors in meetings is associated with a higher probability of challenges (0.58 vs. 0.38). For higher *COMPLEXITY_BARRIERS*, greater availability/use of electronic communication (*ONGOING_ELECTRONIC*) is associated with a lower predicted probability of a challenging audit: 0.44 vs. 0.61 for lower electronic communication availability/use. In contrast, for lower language/cultural barriers, greater electronic communication availability/use is associated with a higher predicted probability of challenges (0.60 vs. 0.36).

Taken together, results of Model 4 continue to show the value of experienced, stable and knowledgeable component auditors in mitigating challenges due to differences in language and culture across teams. Higher levels of component auditor involvement in initial engagement meetings and use of electronic tools have value in mitigating challenges when language and culture differ across teams. However, they are not advantageous when language/cultural barriers are lower.

VI. CONCLUSIONS AND LIMITATIONS

This study contributes to the literature by providing insights on global group audits derived from the salient experiences of highly experienced auditing professionals. Regulators are concerned about the potentially broad impact of low quality global group audits on the financial system (Doty 2011c; PCAOB 2016). However, few studies to date examine this important auditing context. Our results provide the first descriptive evidence available in the literature on work processes in a sample of U.S. global group audit engagements, conducted by Big 4 audit firms in the post-Sarbanes-Oxley environment. Our analysis yields a number of findings new to the literature, summarized in Table 5.

Insert Table 5 About Here

The theoretical basis for our tests is derived from the management literature on geographically distributed work, which proposes that coordination and communication challenges will be exacerbated in complex environments where interdependent teams have low reciprocal predictability of action. In auditing, most client and engagement characteristics that increase complexity (e.g., size, regulatory status, global structure, and countries in which the client operates) are outside the control of the group auditor once the engagement is contracted. The literature on distributed work also proposes several strategies that auditors might adopt to mitigate the challenges faced by interdependent teams in these complex client situations. Of the three strategies we study, we find that the strategy of increasing *tacit coordination* has the highest impact, implying that establishing common ground between team members increases reciprocal predictability of action. Several elements of that strategy are significantly associated with reduction in the probability of challenging engagements across all models. Greater component auditor knowledge has the most widespread effect, mitigating overall effects of three sources of complexity. Additionally, the mitigating effects of greater component auditor experience apply to all levels of global structure and language/cultural barriers, as well as to larger, public companies. Stability in the component audit team mitigates challenges for two sources of complexity (global structure and language/cultural barriers), but is ineffective for larger, public companies. This implies that while a stable component team can assist group auditors to manage engagements when component team structures and team members are diverse, there will still be roadblocks to performing effective and efficient audits for large, public U.S. entities unless the component auditors possess high levels of knowledge and experience specific to the engagement context. In contrast, we find no effect of group audit partner experience, likely because the range is limited due to the five-year limitation on partner tenure for public clients imposed by the Sarbanes-Oxley Act.

The above findings suggest that group auditors should explore opportunities to improve component auditor staffing and cultivate greater knowledge of the industry and U.S. practice. But to what degree are group audit leaders able to influence the composition of foreign component teams to improve tacit coordination? We did not design our study to investigate this issue, but one participant noted in a

comment that group auditors have little control over staffing the component team, especially at lower levels. This issue may be exacerbated when component auditors are out of network, as recent research outside of the auditing context suggests that control over tacit coordination mechanisms may be more difficult if the distributed team members do not belong to the same firm (Srikanth and Puranam 2014).

Our results regarding other strategies show that their effects are contingent on the nature and level of complexity. Particularly, results on modularization are not widespread. Barrett et al. (2005) note that participants in their study relied on a standardized plan to manage work in a low-risk group audit. Our data show that the modularization of work is associated with a reduction of challenges only when clients are small/nonpublic and when global structure is relatively complex (i.e., the group auditor is working with many component teams and the component team performs a statutory audit). Thus, while modularization helps manage a larger number of teams with various incentives, it is apparently counterproductive for large, public clients and does not help to mitigate language/cultural barriers. While a modularization strategy might seem efficient, auditors may fail to appreciate that to work well teams must understand and adhere to the defined plan (or operating procedure) (Srikanth and Puranam 2011).

We also find limited effects of ongoing communication strategies. Greater component auditor involvement in meetings (related to engagement kickoff, discussion of instructions, and fraud brainstorming) is shown to mitigate the effects of a more complex global structure and language/cultural barriers. Greater availability and reliance on electronic tools are also helpful when complexity due to language/cultural barriers is high. Taken together with the weak effects of modularization, our results suggest that “handing off” work to foreign components following preliminary separation and scripting of activities will be ineffective, unless accompanied by continued involvement of component personnel as work is begun and throughout the engagement

For audit practice, these results imply that group auditors should continue to explore opportunities to involve component auditors in initial engagement meetings as a way to increase reciprocal predictability of action. While firms espouse that audit training and tools are largely consistent across global networks, our data show that electronic tools and technologies are employed on a limited basis, and

may not be available to all team members. This may be due to situated practices (i.e., component teams are unfamiliar with or unwilling to adopt such tools) or issues associated with accessing technologies (e.g., internet connectivity). In some respects our results support recent efforts by the PCAOB (2016) to increase communication between the group and component auditor, although it is unclear whether the written communication proposed by regulators will mitigate challenges. While greater communication helps increase reciprocal predictability in teams performing interdependent work (Puranam and Raveendran 2012), written words may be misinterpreted (Cramton 2001) particularly when language and culture of the sender and receiver differ. Further, our findings provide mixed results for written communication as utilized in the modularization strategy, raising questions as to whether regulators' preference for documentation is actually helpful in organizing key aspects of global engagements.

Generalization of the above results is limited by features inherent in our research method and by specific design choices. First, our sample comprises highly challenging and non-challenging global group audit experiences, limiting generalizability to the entire population of global group audits. Second, our use of experiential data may lead to some degree of recall bias. However, we sought engagement experiences that are particularly salient and therefore easier to recall (e.g., Gogan, McLaughlin, and Thomas 2014). To further limit recall bias, we follow prior research (e.g., Gibbins and Trotman 2002) in avoiding leading questions and asking details about the specific experiences before asking about factors that could impact them. Information pertinent to the study was distributed to participants several days in advance to provide ample time for recall, and participants were assured that all responses would remain anonymous and confidential. While some of the variables represent judgments, others are based on factual information that could have been sourced from workpapers if the participant chose to do so.

Third, we limit our focus to the perspective of one party – the group auditor.²⁷ Further research should investigate the nature and extent of challenges experienced from the perspective of the component auditor. The component auditor perspective may also permit researchers to explore factors that influence

²⁷ Another limitation is due to the very small representation of out-of-network component auditors in our sample. Thus, results might not generalize beyond within-network group audits.

engagement staffing (i.e., auditor assignment). The nature of the staffing process for global group audits, both domestically and abroad, is a key research topic for future research to address. Finally, we measure associations among variables and do not imply causation. Future research could specifically assess the contexts in which specific strategies are most effective. For instance, future research could explore contextual features that are most likely to allow for modularization (the strategy most frequently employed in our sample) to overcome challenges as well as whether regulatory requirements (e.g., greater documentation) impact the effectiveness of this strategy.

APPENDIX
Factor Loadings

<i>Variables</i>	<i>Complexity Factors</i>			<i>Strategy Factors</i>				
	<i>SIZE</i>	<i>STRUCTURE</i>	<i>BARRIERS</i>	<i>TACIT_CA_EXPERIENCE</i>	<i>TACIT_CA_STABILITY</i>	<i>TACIT_CA_EXPAT</i>	<i>TACIT_CA_KNOWLEDGE</i>	<i>TACIT_GA_EXPERIENCE</i>
Panel A. Complexity								
<i>REVENUE</i>	0.70	0.33	-0.07					
<i>SEC_REGISTRANT</i>	0.70	-0.04	0.17					
<i>NUMBER_COMPONENTS</i>	0.08	0.60	0.03					
<i>STATUTORY_AUDIT</i>	0.18	0.71	0.00					
<i>WORK_COMPLEXITY</i>	0.18	0.38	-0.01					
<i>SUPERV_COMPONENT</i>	-0.05	0.14	-0.18					
<i>SUB_COMPONENT</i>	0.00	0.23	-0.45					
<i>OTHER_TEAM</i>	0.38	0.21	-0.27					
<i>LANG_BARRIERS</i>	0.05	0.02	0.78					
<i>CULTURAL_BARRIERS</i>	-0.01	0.01	0.76					
Cumulative variance explained	23.5%	47.9%	78.1%					
Panel B. Tacit Coordination								
<i>CA_MGR_EXPERIENCE</i>				0.93	0.05	-0.06	0.04	0.07
<i>CA_PTR_EXPERIENCE</i>				0.37	-0.02	-0.16	0.08	0.23
<i>CA_STABILITY</i>				0.08	0.93	-0.02	0.13	-0.12
<i>CA_US_TOUR</i>				0.04	-0.12	0.14	-0.01	0.01
<i>CA_US_EXPAT</i>				-0.06	-0.05	0.90	0.23	0.06
<i>CA_KNOW_GAAP</i>				0.06	0.02	0.12	0.90	0.02
<i>CA_KNOW_GAAS</i>				0.02	0.12	0.07	0.95	0.07
<i>CA_KNOW_REG_ENV</i>				0.00	0.12	0.12	0.77	0.03
<i>CA_KNOW_INDUSTRY</i>				0.07	0.04	0.09	0.42	0.00
<i>GA_MGR_EXPERIENCE</i>				0.07	-0.05	0.10	0.06	0.13
<i>GA_PTR_EXPERIENCE</i>				0.12	-0.12	0.08	0.04	0.94
<i>CULTURAL_TRAINING</i>				0.28	-0.48	0.30	-0.26	-0.49
<i>WORK_TOGETHER_PRIOR</i>				0.44	0.02	0.21	0.14	0.12
<i>DECISIONS_EXPLAINED</i>				0.04	0.12	0.08	0.21	0.06
Cumulative variance explained				12.3%	23.4%	34.4%	58.8%	70.6%

APPENDIX (continued)
Factor Loadings

<i>Variables</i>	<i>Strategy Factors</i>			
	<i>MODULARIZATION</i>	<i>ONGOING_</i> <i>CONTENT</i>	<i>ONGOING_</i> <i>ELECTRONIC</i>	<i>ONGOING_FTF</i>
Panel C. Modularization				
<i>TAILORED_INSTRUCTIONS</i>	0.69			
<i>TAILORED_WORK</i>	0.69			
<i>PLANNED_INTERACTIONS</i>	0.40			
<i>CA_SCOPED</i>	0.20			
Cumulative variance explained	93.8%			
Panel D. Ongoing Communication				
<i>KICKOFF_MEETING</i>		0.78	0.08	0.12
<i>INSTRUCTIONS_DISCUSSION</i>		0.47	0.00	0.29
<i>FRAUD_BRAINSTORMING</i>		0.74	-0.06	0.14
<i>GUIDANCE_WORK_REMOTELY</i>		0.28	0.48	-0.17
<i>TECHNOLOGY_AVAILABLE</i>		0.00	0.73	-0.03
<i>ELECTRONIC_TOOLS_USE</i>		-0.04	0.65	0.03
<i>COMMUNICATION_FREQ</i>		0.00	0.13	0.15
<i>COMMUNICATION_SPONT</i>		-0.09	0.03	-0.20
<i>FREE_EXCHANGE</i>		0.25	0.03	-0.01
<i>SYNCHRONOUS_VALUED</i>		0.53	0.11	0.36
<i>SYNCHRONOUS_FREQ</i>		0.31	-0.10	0.70
<i>ONSITE_VISIT</i>		0.13	0.37	0.44
Cumulative variance explained		35.4%	60.9%	79.9%

Notes: Variables are defined in Table 1. We use polychoric factor analysis with varimax rotation to identify factors within theoretically derived categories of complexity and mitigating strategies. We retained all factors with eigenvalues greater than 1.0 and use factor loadings of at least .40 to interpret these factors. The bold values represent factor loadings greater than 0.40. Cronbach's alpha is between 0.53 and 0.69 for the three strategies, but is lower for complexity (0.24), indicating this construct has a variety of disparate dimensions. However, Cronbach's alpha assumes underlying continuous distributions, and is biased downward when data are not continuous (Zumbo, Gadermann, & Zeisser 2007).

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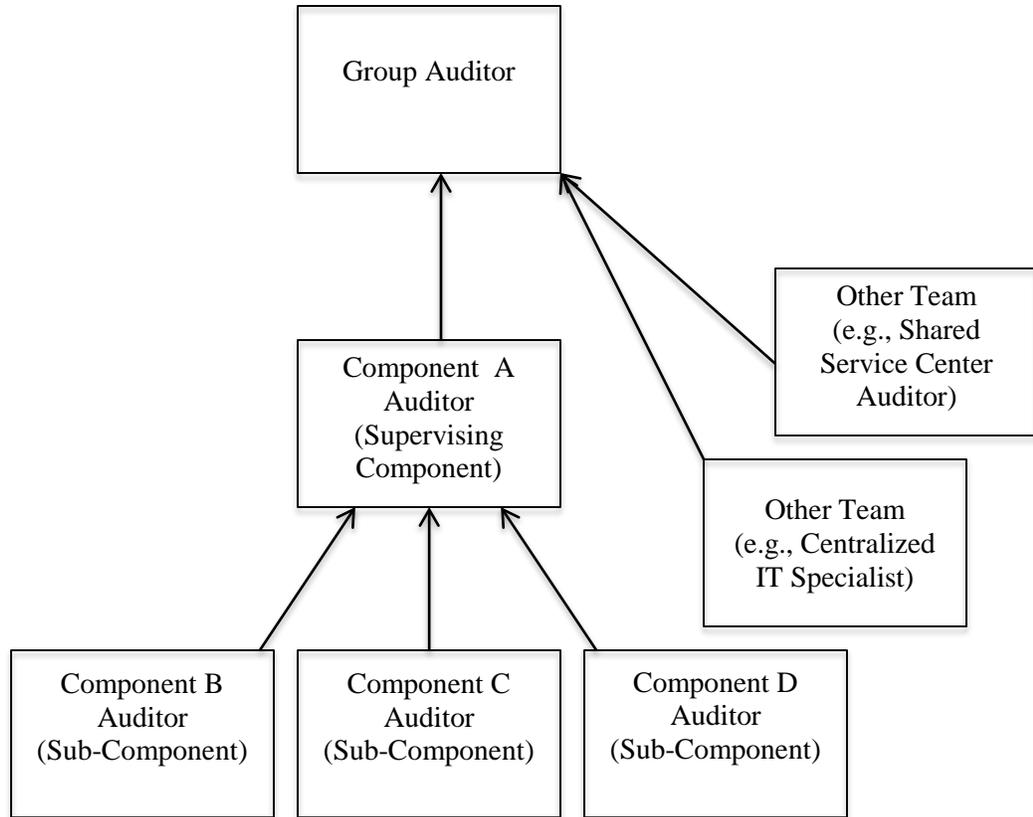
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FIGURE 1
Examples of PCAOB Global Group Audit Inspection Observations and Concerns

Citation	Quote
Modesti 2014	<p><i>“Auditing is an activity that by necessity, occurs across borders. As the largest corporations in the world have become increasingly global, so has the audit. Even in the case of audit reports signed by U.S. audit firms for their largest public company clients, much, if not most, of the audit is done outside the U.S. While the benefits of globalization to capital formation and investment opportunities are significant, globalization also introduces unique audit risks. These risks include divergent cultural biases and business norms, inadequate knowledge of U.S. accounting and audit standards, and differing corporate governance practices. ...These risks can exist either in both the company's financial reporting and disclosure supply chain and the execution of the audit by affiliated network firms.</i></p>
Munter 2014	<p><i>“Inspections staff routinely inspect portions of multiple-firm audits, including the audit work performed by both domestic and non-U.S. firms that played a role in the audit, commonly referred to as referred work. In 2013, our inspectors identified in more than a third of referred work engagements inspected, findings that were so significant that they appeared in Part I of the inspection report. This statistic is significant and concerning — more needs to be done to ensure that all the component auditors involved get it right. Many of these deficiencies related to the testing of revenue and inventory, including testing of controls over those accounts, and insufficient substantive procedures in response to risks of material misstatement. A main lesson to be learned from our multiple-firm inspections is that communication along with supervision and review leads to a better audit.”</i></p>
Doty 2011a	<p><i>“Nearly if not all audits of large companies have some international component today. In the case of many of the largest companies, half or more of the audit may be performed abroad. And in all these cases that means coordination among the various audit firms that make up a network is key. This topic touches on several particularly challenging areas for the PCAOB. As has been widely reported, the PCAOB is unable to inspect audits of firms that have registered with the PCAOB in order to be able to conduct or participate in audits of U.S. public companies but that are located in certain jurisdictions that have resisted inspections. This means enormous components of the audits of multi-national companies escape review, even when the firm that signed the audit report is a large U.S. accounting firm.”</i></p>
Doty 2011c	<p><i>“PCAOB inspectors have reviewed portions of numerous components of audits that principal auditors had determined were necessary and instructed affiliates to perform. If you are involved in multi-national audits, this should be of significance to you: in many cases, inspectors determined that the affiliate failed to accomplish the objectives of the instructions provided by the principal auditor, sometimes in multiple respects. These deficiencies were identified both abroad and here in the U.S. That is, some were in situations where the principal auditor was outside the U.S., but the subsidiary auditor was in the U.S., and the rest vice versa. Inspectors have found obvious errors that could have, and should have, been picked up by the principal auditor, if communication between the two auditors had been more robust. For example, inspectors have found unresolved audit issues between affiliates. One inspection team found a situation where the affiliate consistently failed to perform audit procedures, unbeknownst to the principal auditor until our inspectors conducted their review.</i></p>

Notes: This figure presents above excerpts from speeches by PCAOB board and staff members, illustrating concerns for global group audits, particularly relating to coordination and communication challenges (emphases added). These quotes provide insight into global group audit challenges beyond publicly available inspection reports, which do not distinguish issues related to global group audits, group auditor work, or component audit work from other audit work.

FIGURE 2
Organizational Structure of the Engagement: Supervising Component, Sub-Component, and Other Team Reporting



Notes: Component A Auditor supervises Component B, C, and D Auditors, reporting the consolidated component work to the group auditor. Component B, C, and D Auditors indirectly report to the group auditor through the auditor of Component A. The Other Teams report their portion of the component audit work performed (e.g., receivables tested at the Shared Service Center or general controls over the ERP system) to the Group Auditor for consolidating with the other component audit work or communication to the component engagement team.

FIGURE 3
Coordination and Communication Strategies

Tacit Coordination	Modularization	Ongoing Communication
<i>Leverage common ground through shared experience and knowledge</i>	<i>Efforts to reduce interdependencies through advance coordination of work</i>	<i>Content, method, and ease of communication during the engagement</i>
<p>Experience:</p> <ul style="list-style-type: none"> • Tenure of the group and component audit leaders • Previous experience working together • Turnover of component audit staff <p>Knowledge:</p> <ul style="list-style-type: none"> • U.S. regulatory environment, GAAP, GAAS, and industry standard knowledge • Cultural training • U.S. tour for component auditor • Secondment to component location for group auditor • Explaining implicit local contextual features influencing decision making 	<ul style="list-style-type: none"> • Tailoring component audit instructions and work • Standardized procedures (or a plan) for interactions • Component auditor scopes work to be performed 	<p>Content:</p> <ul style="list-style-type: none"> • Kickoff meeting • Discussion of written instructions • Fraud brainstorming meeting <p>Method:</p> <ul style="list-style-type: none"> • On-site visits • Synchronous communication (e.g., telephone or web conferencing). • Guidance on how to work remotely • Availability and use of technologies/ electronic tools to share work-in-process <p>Ease of communication:</p> <ul style="list-style-type: none"> • Frequency of communication • Spontaneous communication • Free exchange of information

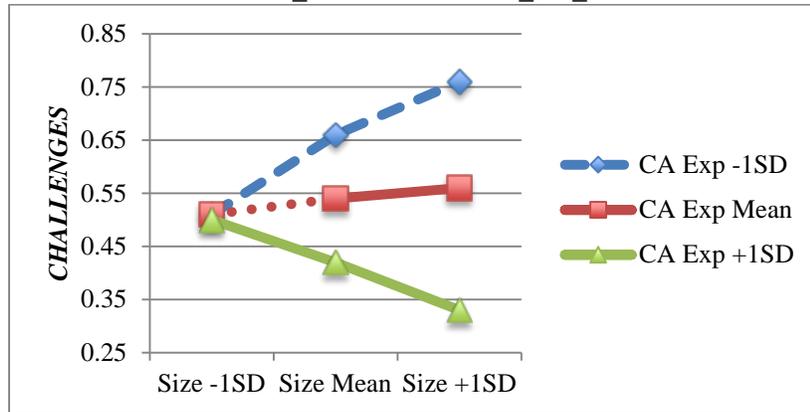
Notes: This figure illustrates the three coordination and communication strategies of focus in our analysis.

FIGURE 4

Predicted Probabilities for Interactive Effects of Complexity and Strategies on *CHALLENGING*

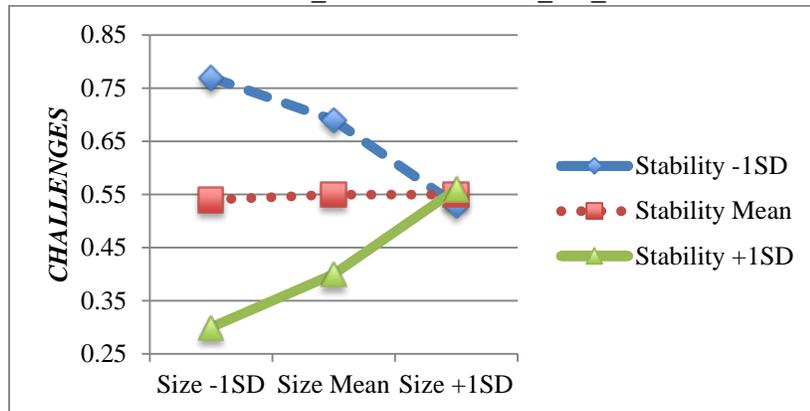
Panel A. Interaction of Size with Component Auditor Experience

COMPLEXITY_SIZE and *TACIT_CA_EXPERIENCE*



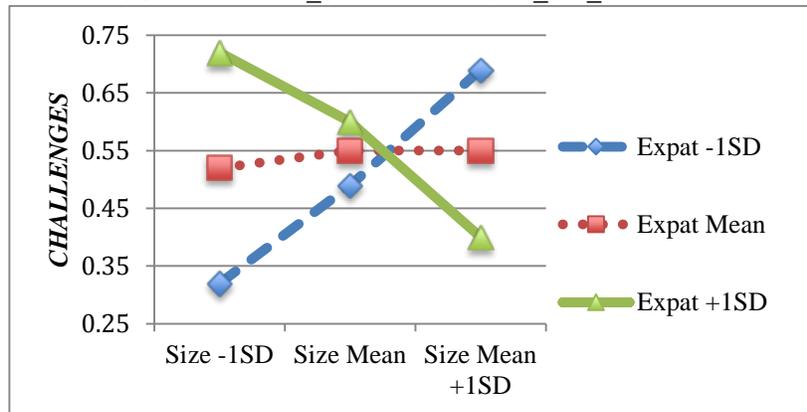
Panel B. Interaction of Size with Component Auditor Stability

COMPLEXITY_SIZE and *TACIT_CA_STABILITY*



Panel C. Interaction of Size and Component Auditor Expat

COMPLEXITY_SIZE and *TACIT_CA_EXPAT* *

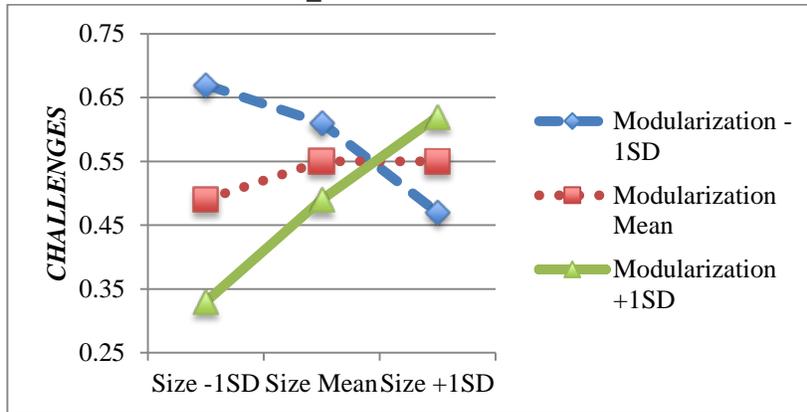


*A similar pattern is also observed for language and cultural barriers (*COMPLEXITY_BARRIERS*) and content of ongoing communication (*ONGOING_CONTENT*), as well as *COMPLEXITY_BARRIERS* and the availability/use of electronic communication (*ONGOING_ELECTRONIC*).

FIGURE 4 (continued)
Predicted Probabilities for Interactive Effects of Complexity and Strategy on *CHALLENGING*

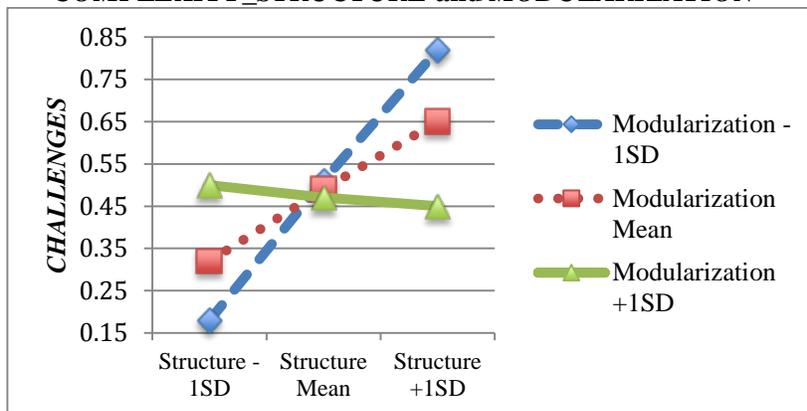
Panel D. Interaction of Size and Modularization

COMPLEXITY_SIZE* and *MODULARIZATION



Panel E. Interaction of Structure and Modularization

***COMPLEXITY_STRUCTURE* and *MODULARIZATION* ***



*A similar pattern is also observed for structure (*COMPLEXITY_STRUCTURE*) and content of ongoing communication (*ONGOING_CONTENT*).

Notes: This figure illustrates patterns of predicted probabilities of *CHALLENGES* for significant interactions at the mean of each factor, and one standard deviation above and below the mean, with other independent variables held at the average of their predicted values. For brevity, similar patterns are only illustrated once, as noted in the respective panels.

TABLE 1
Variable Definitions and Descriptive Statistics (Means and Std. Dev)

<i>Variable Name</i>	<i>Variable Description</i>	<i>Total Sample</i>	<i>Challenging (n=74)</i>	<i>Non-Challenging (n=73)</i>	<i>t or Z</i>
		Mean (Std. Dev) or %=1			
Dependent Variable					
<i>CHALLENGING</i>	1 = Global group audit experience was identified as challenging; 0 = Non-challenging				
Panel A. Complexity					
<i>REVENUE</i>	Annual revenues of the company at the time of the experience; from 1 ("<=\$25 million") to 5 (">\$5 billion")	4.1 (1.0)	4.2 (0.9)	3.9 (1.1)	1.8**
<i>SEC_REGISTRANT</i>	1 = Client is an SEC registrant; 0 = Otherwise	86.4%	85.1%	87.7%	-0.4
<i>NUMBER_COMPONENTS</i>	Number of components involved in this global engagement	8.9 (8.6)	10.7 (9.8)	7.1 (6.8)	2.7***
<i>STATUTORY_AUDIT</i>	1 = Component auditor performed a statutory audit in addition to the work completed for the group audit; 0 = Otherwise	87.1%	90.5%	83.6%	1.3
<i>WORK_COMPLEXITY</i>	Complexity of audit work performed by component auditor; from 1 ("Very Low") to 11 ("Very High")	6.3 (1.9)	6.3 (1.6)	6.3 (2.1)	0.1
<i>SUPERV_COMPONENT</i>	1 = Component with a number of sub-components under its supervision; 0 = Otherwise	8.8%	6.8%	11.0%	-0.9
<i>SUB_COMPONENT</i>	1 = Component auditor reported indirectly to the group auditor through another component engagement team; 0 = Otherwise	9.5%	9.5%	9.6%	-0.3
<i>OTHER_TEAM</i>	1 = Team other than the component auditor performs a portion of the audit work; 0 Otherwise	51.0%	52.7%	49.3%	0.4
<i>LANG_BARRIERS</i>	Extent to which a language barrier existed between the group and component auditors; from 0 ("Not At All") to 11 ("Very High")	2.9 (2.8)	3.1 (3.0)	2.5 (2.5)	1.3*
<i>CULTURAL_BARRIERS</i>	Extent to which a cultural barrier existed between the group and component auditors; from 0 ("Not At All") to 11 ("Very High")	3.9 (2.7)	4.1 (2.7)	3.7 (2.7)	0.8
Panel B. Tacit Coordination					
<i>CA_MGR_EXPERIENCE</i>	Number of years the component audit manager had worked on this engagement	8.0 (3.4)	7.4 (3.6)	8.6 (3.2)	-2.1**
<i>CA_PTR_EXPERIENCE</i>	Number of years the component audit partner had worked on this engagement.	3.6 (2.2)	3.5 (2.3)	3.8 (2.1)	-0.9

TABLE 1 (continued)
Variable Definitions and Descriptive Statistics (Means and Std. Dev)

<i>Variable Name</i>	<i>Variable Description</i>	<i>Total Sample</i>	<i>Challenging (n=74)</i>	<i>Non-Challenging (n=73)</i>	<i>t or Z</i>
		Mean (Std. Dev) or %=1			
<i>CA_STABILITY</i>	1 = Component engagement team did not include new staff; 0 = Otherwise	64.6%	54.1%	75.3%	-2.7***
<i>CA_US_TOUR</i>	1 = Component engagement team included a local auditor who worked as an expat in the U.S. in the last five years; 0 = Otherwise	21.1%	17.6%	24.7%	-1.1
<i>CA_US_EXPAT</i>	1 = Component engagement team included a member of the U.S. firm (e.g., secondment or expatriate); 0 = Otherwise	19.7%	18.9%	20.5%	-0.2
<i>CA_KNOW_GAAP</i>	Extent to which the component engagement team understood U.S. GAAP; from 1 (“Very Low”) to 11 (“Very High”)	8.3 (1.8)	8.0 (1.8)	8.6 (1.7)	-2.2**
<i>CA_KNOW_GAAS</i>	Extent to which the component engagement team understood U.S. GAAS; from 1 (“Very Low”) to 11 (“Very High”)	8.1 (1.7)	7.7 (1.7)	8.6 (1.7)	-3.0***
<i>CA_KNOW_REG_ENV</i>	Extent to which the component engagement team understood U.S. regulatory oversight; from 1 (“Very Low”) to 11 (“Very High”)	7.2 (2.2)	6.7 (2.0)	7.7 (2.2)	-2.9***
<i>CA_KNOW_INDUSTRY</i>	Extent to which the component engagement team understood the component’s industry; from 1 (“Very Low”) to 11 (“Very High”)	9.0 (1.6)	8.7 (1.7)	9.4 (1.5)	-2.7***
<i>GA_MGR_EXPERIENCE</i>	Number of years the group audit manager had worked on this engagement	4.2 (2.8)	4.0 (2.8)	4.4 (2.8)	-0.8
<i>GA_PTR_EXPERIENCE</i>	Number of years the group audit partner had worked on this engagement	3.5 (2.5)	3.7 (2.7)	3.3 (2.4)	1.0
<i>CULTURAL_TRAINING</i>	1 = Group engagement team received training on cultural differences prior to the engagement commencing; 0 = Otherwise	4.1%	4.1%	4.1%	0.2
<i>WORK_TOGETHER_PRIOR</i>	Extent to which the group engagement team worked with the component engagement team in prior periods or another engagement; from 0 (“Not At All”) to 11 (“Very High”)	7.2 (2.9)	6.6 (3.1)	7.8 (2.6)	-2.6***
<i>DECISIONS_EXPLAINED</i>	Extent the group auditor was aided in understanding how the component auditor arrived at decisions in planning, executing and concluding field work; from 0 (“Not At All”) to 11 (“Very High”)	7.4 (2.0)	7.0 (2.0)	7.7 (1.9)	-2.0**

TABLE 1 (continued)
Variable Definitions and Descriptive Statistics (Means and Std. Dev)

<i>Variable Name</i>	<i>Variable Description</i>	<i>Total Sample</i>	<i>Challenging (n=74)</i>	<i>Non-Challenging (n=73)</i>	<i>t or Z</i>
		Mean (Std. Dev) or %=1			
Panel C. Modularization					
<i>TAILORED_INSTRUCTIONS</i>	Extent to which the initial instructions were tailored to minimize need for interactions between the group and component auditor; from 0 (“Not At All”) to 11 (“Very High”)	7.9 (2.0)	7.7 (2.1)	8.1 (1.8)	-1.5*
<i>TAILORED_WORK</i>	Extent to which the component work was tailored to minimize need for interactions between the group and component auditor; from 0 (“Not At All”) to 11 (“Very High”)	7.0 (2.2)	6.7 (2.2)	7.3 (2.3)	-1.7**
<i>PLANNED_INTERACTIONS</i>	Extent to which the initial engagement plan stipulated the nature and timing of substantially all interactions between group and component auditor; from 0 (“Not At All”) to 11 (“Very High”)	8.4 (1.8)	8.3 (1.8)	8.5 (1.8)	-0.6
<i>CA_SCOPED</i>	1 = Component audit procedures were scoped (i.e., designed/determined) by the component engagement team; 0 = Otherwise	10.9%	8.1%	13.7%	-1.1
Panel D. Ongoing Communication					
<i>KICKOFF_MEETING</i>	1 = Component auditor participated with the group auditor in the kick-off or planning meeting; 0 = Otherwise	72.1%	74.3%	69.9%	0.6
<i>INSTRUCTIONS_DISCUSSION</i>	1 = Component auditor participated with the group auditor in discussions of the audit plan/instructions; 0 = Otherwise	79.6%	74.3%	84.9%	-1.6*
<i>FRAUD_BRAINSTORMING</i>	1 = Component auditor participated with the group auditor in the fraud brainstorming meeting; 0 = Otherwise	54.4%	50.0%	58.9%	-1.1
<i>GUIDANCE_WORK_REMOTELY</i>	Extent to which the group engagement team received guidance on working remotely with component auditors efficiently and effectively; from 0 (“Not At All”) to 11 (“Very High”)	4.7 (2.9)	4.9 (2.8)	4.5 (2.9)	0.9
<i>TECHNOLOGY_AVAILABLE</i>	Extent to which technologies were available to communicate information, e.g., shared platforms, databases, web portals, or dedicated intranet sites; from 0 (“Not At All”) to 11 (“Very High”)	5.1 (3.6)	5.2 (3.5)	5.1 (3.7)	0.2
<i>ELECTRONIC_TOOLS_USE</i>	Extent to which electronic tools were used to enable remote collaboration, e.g., Net Meeting, instant messaging, application sharing; from 0 (“Not At All”) to 11 (“Very High”)	4.2 (3.1)	4.3 (3.0)	4.1 (3.2)	0.5

TABLE 1 (continued)
Variable Definitions and Descriptive Statistics (Means and Std. Dev)

<i>Variable Name</i>	<i>Variable Description</i>	<i>Total Sample</i>	<i>Challenging (n=74)</i>	<i>Non-Challenging (n=73)</i>	<i>t or Z</i>
		Mean (Std. Dev) or %=1			
<i>COMMUNICATION_FREQ</i>	Average number of times per week that the group auditor communicated with the component auditor during the planning, fieldwork, and reporting phases of the audit	1.8 (1.3)	1.9 (1.3)	1.7 (1.3)	0.9
<i>COMMUNICATION_SPONT</i>	Extent to which communication between the group and component auditor was considered to be spontaneous; from 0 (“Not At All”) to 11 (“Very High”)	6.8 (2.1)	7.0 (2.0)	6.6 (2.1)	1.2
<i>FREE_EXCHANGE</i>	Extent to which information was considered to be freely exchanged between the group and component auditor; from 0 (“Not At All”) to 11 (“Very High”)	8.4 (2.0)	8.0 (2.3)	8.8 (1.6)	-2.5***
<i>SYNCHRONOUS_VALUED</i>	1 = Communication method most valued was a synchronous medium; 0 = Otherwise	73.5%	78.4%	68.5%	1.4*
<i>SYNCHRONOUS_FREQ</i>	1 = Communication method most frequently used was a synchronous medium; 0 = Otherwise	10.9%	9.5%	12.3%	-0.6
<i>ONSITE_VISIT</i>	1 = Group audit manager or partner visited the component audit location to review last year’s work papers, or to plan and execute the current audit; 0 = Otherwise	57.8%	58.1%	57.5%	0.1
Panel E. Control Variables					
<i>AUDITPLAN_CHANGE</i>	Significance of changes in scoping, audit approach, materiality, or procedures; from 0 (“Not At All”) to 11 (“Very High”)	1.9 (3.2)	2.4 (3.5)	1.4 (2.7)	1.8**

Notes: This table presents descriptive statistics on variables submitted to polychoric factor analysis and control variables used in Models 1-4, for the sample of 147 observations with complete data. Differences between challenging and non-challenging components are tested using t- (Z-) statistics for continuous (dichotomous) variables. ***, **, * indicate significance at p<0.01, 0.05 and 0.10, respectively.

TABLE 2
Factor Descriptions and Inter-Factor Correlations

<i>Factor [Interpretation]</i>	<i>Percent of construct variance explained</i>	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>	<i>6</i>	<i>7</i>	<i>8</i>	<i>9</i>	<i>10</i>	<i>11</i>	<i>12</i>
Complexity Factors													
<i>1. COMPLEXITY_SIZE</i> [Complexity due to company size and SEC registrant status]	23.5%	1.00											
<i>2.COMPLEXITY_STRUCTURE</i> [Complexity due to statutory audit requirements and number of components included on the engagement]	24.4%	0.11	1.00										
<i>3. COMPLEXITY_BARRIERS</i> [Complexity due to language and cultural barriers]	30.2%	-0.00	0.05	1.00									
Tacit Coordination Factors													
<i>4. TACIT_CA_EXPERIENCE</i> [Component audit manager experience on the engagement and component auditor experience working with the group auditor]	12.3%	0.19	0.19	-0.02	1.00								
<i>5. TACIT_CA_STABILITY</i> [Component audit staff stability year-over-year]	11.1%	-0.06	-0.08	-0.08	-0.41	1.00							
<i>6. TACIT_CA_EXPAT</i> [Component audit team includes a U.S. expatriate]	10.0%	0.14	0.14	-0.05	-0.02	0.07	1.00						

TABLE 2 (continued)
Factor Descriptions and Inter-Factor Correlations

<i>Factor [Interpretation]</i>	<i>Percent of construct variance explained</i>	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>	<i>6</i>	<i>7</i>	<i>8</i>	<i>9</i>	<i>10</i>	<i>11</i>	<i>12</i>
<i>7. TACIT_CA_KNOWLEDGE</i> [Component auditor knowledge of U.S. standards, regulatory environment, and industry]	25.4%	0.11	-0.03	-0.17	0.14	-0.19	-0.07	1.00					
<i>8. TACIT_GA_EXPERIENCE</i> [Group audit partner experience on the engagement and cultural training]	11.8%	0.01	0.10	-0.02	0.16	-0.15	0.05	-0.02	1.00				
Modularization Factor													
<i>9. MODULARIZATION</i> [Minimizing interdependencies and standardizing interactions]	93.8%	0.04	-0.12	-0.08	0.14	-0.13	0.00	0.19	-0.03	1.00			
Ongoing Communication Factors													
<i>10. ONGOING_CONTENT</i> [Component auditor involvement in planning and fraud meetings, and the value of synchronous communication to group auditor]	35.4%	0.10	-0.02	-0.10	-0.01	0.19	-0.02	0.00	-0.01	0.01	1.00		
<i>11. ONGOING_ELECTRONIC</i> [Availability and use of technology/electronic tools, and guidance on how to work remotely]	25.5%	0.22	0.15	0.01	0.12	-0.10	0.03	0.11	0.01	0.02	0.03	1.0	
<i>12. ONGOING_FTF</i> [Group auditor visits component auditor to meet face-to-face and synchronous communication use]	19.0%	0.13	0.12	-0.09	0.09	-0.26	0.14	0.14	0.03	0.03	0.01	-0.02	1.0

Notes: This table presents names and interpretations for factor variables representing complexity and coordination/communication strategies used in the models, percentage of variance explained by the factors, and correlations among them. See the Appendix for details of polychoric factor analysis, as well as factor loadings. Means (standard deviations) for all factors are 0 (1). Significant correlations between factors at $p < 0.05$ (two-tailed) are bolded.

TABLE 3
Descriptive Statistics - Coordination and Communication Challenges Experienced

<i>Variable Name</i>	<i>Variable Description</i>	<i>Mean (Std. Dev) or %=1</i>
Panel A. Importance, Breadth, and Anticipation of Challenges		
<i>CHALLENGE_IMPORTANCE</i>	Perceived importance of challenge experienced on the global group audit, from 1 (“Very Low”) to 11 (“Very High”)	7.0 (2.1)
<i>CHALLENGING_COMPONENTS</i>	The proportion of components where significant challenges were encountered to the total number of components involved in this engagement	29.6%
<i>CHALLENGES_ANTICIPATED</i>	The extent to which the group auditor anticipated the challenges prior to planning, from 0 (“Not At All”) to 11 (“Very High”)	5.6 (2.6)
Panel B. Types of Challenges Experienced		
<i>Execution of Audit Work</i>		
<i>OBTAINING_CLARITY</i>	1 = Challenge experienced related to obtaining clarity around documentation, open items, or matters arising from review; 0 = Otherwise	52.7%
<i>COMMUNICATING_COORDINATING</i>	1 = Challenge experienced related to communicating and coordinating the audit strategy, important updates and information; 0 = Otherwise	52.7%
<i>ADDITIONAL_PROCEDURES</i>	1 = Challenge experienced related to designing and performing additional audit procedures for the component; 0 = Otherwise	33.7%
<i>INVOLVING_GA</i>	1 = Challenge experienced related to appropriately involving the group auditor in the component auditor's work; 0 = Otherwise	25.7%
<i>Variation</i>		
<i>RISK_VARIATION</i>	1 = Challenge experienced related to variation between risks assessed by the component and the group auditors; 0 = Otherwise	12.2%
<i>WORK_VARIATION</i>	1 = Challenge experienced related to variation between work outlined in the instructions and work performed at the component; 0 = Otherwise	31.1%
<i>Timing</i>		
<i>NONTIMELY_COMMUNICATION</i>	1 = Challenge experienced related to timely communication of exceptions identified, significant financial reporting or auditing matters, internal control issues, or other relevant matters; 0 = Otherwise	41.9%
<i>NONTIMELY_COMPLETION</i>	1 = Challenge experienced related to timely and/or efficient completion of component audit work; 0 = Otherwise	58.1%
<i>SUBSEQUENT_DISCOVERY</i>	1 = Challenge experienced related to subsequent discovery of information during statutory audit work, which affected the group audit; 0 = Otherwise	6.8%

Notes: This table presents descriptive statistics on variables for the sample of 74 challenging observations with complete data. These variables are not previously defined in Table 1 and are not used in the polychoric factor analysis or probit models, but do provide insights into challenge(s) experienced on each engagement. Participants were asked to select all challenges that applied.

TABLE 4
Sources of Complexity and the Role of Mitigating Strategies in Distinguishing Challenging vs. Non-challenging Global Group Audits

<i>Complexity measured as:</i>	<i>A. Main Effects (Model 1)</i>	<i>B. Interactions with Size (Model 2)</i>	<i>C. Interactions with Structure (Model 3)</i>	<i>D. Interactions with Barriers (Model 4)</i>
Test Variables				
<i>COMPLEXITY_SIZE (+)</i>	0.25*	-0.02		
<i>COMPLEXITY_STRUCTURE (+)</i>	0.44**		0.57***	
<i>COMPLEXITY_BARRIERS (+)</i>	0.02			0.08
<i>TACIT_CA_EXPERIENCE (-)</i>	-0.39***	-0.41***	-0.40***	-0.38***
<i>[complexity]*CAEXP</i>		-0.39**	-0.17	0.11
<i>TACIT_CA_STABILITY (-)</i>	-0.29***	-0.49***	-0.31***	-0.28**
<i>[complexity]*STABILITY</i>		0.57*	-0.15	-0.11
<i>TACIT_CA_EXPAT (-)</i>	-0.03	0.18	-0.06	-0.04
<i>[complexity]*EXPAT</i>		-0.77***	-0.01	-0.07
<i>TACIT_CA_KNOWLEDGE (-)</i>	-0.33***	-0.39***	-0.45***	-0.35***
<i>[complexity]*KNOWL</i>		-0.09	-0.05	0.04
<i>TACIT_GA_EXPERIENCE (-)</i>	0.09	0.07	0.08	0.12
<i>[complexity]*GAEXP</i>		0.11	0.03	-0.11
<i>MODULARIZATION (-)</i>	-0.14	-0.21	-0.08	-0.09
<i>[complexity]*MODULAR</i>		0.52**	-0.65**	-0.07
<i>ONGOING_CONTENT (-)</i>	0.00	0.04	0.04	0.10
<i>[complexity]*CONTENT</i>		-0.29	-0.60**	-0.25*
<i>ONGOING_ELECTRONIC (-)</i>	0.09	0.16	0.12	0.07
<i>[complexity]*ELECTRONIC</i>		-0.16	0.06	-0.34**
<i>ONGOING_FTF (-)</i>	-0.15	-0.09	-0.16	-0.20
<i>[complexity]*FTF</i>		-0.22	-0.11	0.22
Control Variables				
<i>COMPLEXITY_SIZE (+)</i>			0.27*	0.50***
<i>COMPLEXITY_STRUCTURE (+)</i>		0.37**		0.28**
<i>COMPLEXITY_BARRIERS (+)</i>		0.05	-0.01	
<i>AUDITPLAN_CHANGE (+)</i>	0.07**	.09**	0.08**	0.08**
<i>{Industry indicators}</i>				
Intercept	-0.22	-0.13	-0.27	-0.21
Pseudo-R ² , Area under ROC	0.19, 0.78	0.28, 0.83	0.23, 0.81	0.21, 0.80
N	147	147	147	147

TABLE 4 (Continued)
Sources of Complexity and the Role of Mitigating Strategies in Distinguishing Challenging vs. Non-challenging Global Group Audits

Notes: This table presents results of probit regression models whose dependent variable is *CHALLENGING*, which equals 1 for engagements selected by participants as representing global group audit experiences with significant challenges; 0 for engagements selected as representing their non-challenging experiences. Independent variables are factors derive from polychoric factor analysis (see the Appendix for factor loadings and Table 2 for interpretations of meaning). Column A presents a main effects model, showing overall associations of sources of complexity and strategies with challenging engagements. Columns B through D present a series of models that interact specific strategy factors with each source of complexity, entered separately due to the large number of interactions that would occur in a single model. [*complexity*] in variable names for the interaction terms refers to the specific source of complexity interacted in each model. Column B presents interactions of strategies with *COMPLEXITY_SIZE*, Column C presents interactions of strategies with *COMPLEXITY_STRUCTURE*, and Column D presents interactions of strategies with *COMPLEXITY_BARRIERS*. Z-statistics are calculated based on robust standard errors clustered by respondent. ***, **, and * indicate significance at $p < 0.01$, 0.05 and 0.10, respectively, with probabilities presented as one-tailed for directional expectations and two-tailed for all other results.

Table 5
Summary of Results

	<i>A. Complexity due to size/regulatory status</i>	<i>B. Complexity due to global structure</i>	<i>C. Complexity due to language/cultural barriers</i>
<i>Component auditor engagement experience</i>	Decreasing challenges when size is higher	Decreasing challenges overall	Decreasing challenges overall
<i>Component audit staff stability year-over-year</i>	Decreasing challenges when size is lower	Decreasing challenges overall	Decreasing challenges overall
<i>Component audit team includes U.S. expat</i>	Decreasing (Increasing) challenges when size is higher (lower)	N.S.	N.S.
<i>Component auditor knowledge of GAAS, GAAP, and U.S. regulation</i>	Decreasing challenges overall	Decreasing challenges overall	Decreasing challenges overall
<i>Group audit partner engagement experience</i>	N.S.	N.S.	N.S.
<i>Modularization (minimizing interdependencies to reduce later communication)</i>	Increasing (Decreasing) challenges when size is higher (lower)	Decreasing (Increasing) challenges when structural complexity is higher (lower)	N.S.
<i>Component auditor involvement in engagement kickoff, discussion of instructions, fraud brainstorming meetings</i>	N.S.	Decreasing (Increasing) challenges when structural complexity is higher (lower)	Decreasing (Increasing) challenges when language/cultural barriers are higher (lower)
<i>Availability/use of electronic tools, and guidance on how to work remotely</i>	N.S.	N.S.	Decreasing (Increasing) challenges when language/cultural barriers are higher (lower)
<i>Face-to-face-communication</i>	N.S.	N.S.	N.S.

Notes: This table summarizes results of models 2-4 presented in Table 4, investigating which specific sources of complexity are associated with significantly challenging global group audits, and whether audit firms' use of certain management strategies, discussed in the literature on geographically distributed work, mitigate the effect of complexity on those challenges. Complexity and strategy variables are developed from polychoric factor analysis. Shaded cells indicate effects of strategies that are significant across the sample, or when complexity is relatively high (i.e., when the strategy provides the most benefit). N.S. denotes non-significant results.



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29 July 2016

**Re: Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Accounting Firm
PCAOB Rulemaking Docket Matter No. 042**

Dear Ms. Brown:

Ernst & Young LLP is pleased to submit these comments to the Public Company Accounting Oversight Board (PCAOB or Board) on its proposed amendments relating to the supervision of audits involving other auditors and proposed auditing standard – *Dividing Responsibility for the Audit with Another Accounting Firm* (collectively, the Proposal).

We support the PCAOB's efforts to strengthen the requirements for the lead auditor in an audit involving other auditors. Other auditors perform important work in many audits, and we agree that the lead auditor needs to be appropriately involved in and appropriately evaluate the work of other auditors. We believe that many of the changes contemplated in the Proposal would improve the quality of these audits and benefit investors.

We also appreciate that the Board is considering the work of other standard setters, such as the International Auditing and Assurance Standards Board (IAASB), on this important topic. We encourage the Board, where appropriate, to continue to engage with the IAASB to understand the responses it received to its "Invitation to Comment" that explores, among other things, improvements in group audits. As both international auditing standards and the PCAOB standards have wide-reaching global use, minimizing any unnecessary differences between them can prevent confusion or misapplication by auditors that conduct audits under both sets of standards and would further improve audit quality.

Our comments below focus primarily on areas where we believe the Proposal might be improved or made more practical. We highlight the key areas of concern immediately below and then follow with further discussion on these and other topics along with proposed alternatives.

The lead auditor determination and the importance of a risk-based approach

We believe that the proposed amendments that would require an auditor to evaluate whether it is the lead auditor require further study. We think those proposed amendments would result in a change in practice that could have some unintended consequences, including situations in which no auditor

could participate sufficiently to qualify to serve as the lead auditor. In addition, requiring an auditor to perform work in other locations to satisfy the Proposal's sufficiency criteria could increase the risk of deficiencies, thereby diminishing audit quality, such as when an auditor works in another country and may not fully appreciate how different business practices and market conditions could affect its risk assessments. This concept is discussed in the "Lead auditor determination" section of this letter.

We support the Board's objective of requiring a risk-based approach. However, in several areas, the Proposal appears to introduce fairly specific or prescriptive requirements that do not appear to be scalable based on the assessed risk. Examples include the proposed requirement for the engagement quality reviewer (EQR) to evaluate the engagement partner's determination that participation is sufficient, the proposed requirement for the lead auditor to review the nature, timing and extent of the procedures performed by other auditors, and the proposed requirement to include a list of workpapers of other auditors that the lead auditor reviewed.

Allowing the lead auditor to exercise professional judgment when determining the extent of supervision required would encourage the lead auditor to give greater consideration to areas and components that are more likely to contain risks of material misstatement, which we believe would positively contribute to audit quality. We offer some suggestions to further those objectives.

Distinguishing the approach for in-network firms

As we discuss in more detail later in our letter, the Proposal does not differentiate between in-network and out-of-network firms. Based on our understanding, any audit firm participating in the audit other than the lead auditor would be considered an other auditor. The proposal does not appear to consider the structure of the multinational network firms that are designed to address the basic supervision and review concepts included in the proposed amendments. We believe any final standard should be scalable based on risk and permit lead auditors that are part of multinational network firms with consistent audit methodologies and independence, ethics and training compliance policies to rely on the firm's system of quality control when evaluating other auditors that are in their network. That would allow for the scalability of the standard and enable lead auditors to achieve the Proposal's objectives in a more cost-effective manner.

Supplementing the definitions

We agree that the definitions in the Proposal are helpful, but we suggest supplementing the definitions of "lead auditor" and "other auditor" in order to address situations where we believe the definitions may miscategorize who is part of the lead auditor and the other auditor as defined in the Proposal.

We also suggest a change in the definition used for "substantial role" in the Proposal and a change in the proposed communication requirements so that a consistent structure of communications exists between "first other auditors" and "second other auditors". Finally, we observe a need for guidance on the form and content of reports that other auditors provide to the lead auditor.

Providing more guidance on dividing responsibility

Finally, while we support the Board's approach of proposing a separate standard on dividing responsibility in an audit, we have identified a few areas where additional guidance is needed in the new proposed standard on the circumstances when an auditor would divide responsibility and to allow for divided responsibility when financial reporting frameworks differ.

Further discussion

AS 2101, Audit Planning

Lead auditor determination

As mentioned previously, we believe that further study is needed before finalizing the proposed amendments to AS 2101 to determine the sufficiency of participation to serve as lead auditor. Those amendments could result in some unintended consequences, including situations where no auditor could be identified as the lead auditor.

Based on our understanding of the rules governing the practice of accountancy in the United States, all states, including the District of Columbia and other US territories, define the issuance of audit reports as the practice of public accountancy. Almost every state requires that audit reports issued to companies headquartered in the US be issued by an auditor licensed by a US State Board of Accountancy. Furthermore, the majority of US jurisdictions require audit reports issued to companies headquartered in a particular state to be issued by an auditor licensed in that state.¹

While the Securities and Exchange Commission specifically permits a non-US public accounting firm that is registered with the PCAOB to issue the report, the vast majority of state laws do not. Even if substantially all operations of the entity reside outside of certain states or the US, the audit opinion must still be issued by a firm licensed in that state. And to obtain a license to practice public accounting in that state, state laws also often require that the firm be majority-owned by US certified public accountants. As a result, a non-US public accounting firm would generally be unable to issue the report in many cases.

¹ The following state laws are representative of the requirements in the majority of U.S. jurisdictions:

California Cal. Bus. & Prof. Code § 5072(a) states that “No persons shall engage in the practice of accountancy as a partnership unless the partnership is registered by the board.” Section 5096(d) states, “(d) An individual who qualifies for the practice privilege under this section may perform the following services only through a firm of certified public accountants that has obtained a registration from the board pursuant to Section 5096.12: (1) An audit or review of a financial statement for an entity headquartered in California.” Cal. Bus. & Prof. Code § 5096(d)(1).

New York N.Y. Educ. Law § 7408(3)(a) states that “Any firm that is established for the business purpose of lawfully engaging in the practice of public accountancy pursuant to subdivisions one and two of section seventy-four hundred one of this article or uses the title “CPA” or “CPA firm” or the title “PA” or “PA firm” must register with the department.” Section 7401 defines the practice of public accountancy to include (1) offering to perform or performing attest and/or compilation services, as defined in section seventy-four hundred one-a of this article; (2) incident to the services described in subdivision one of this section, offering to perform or performing professional services for clients, in any or all matters relating to accounting concepts and to the recording, presentation, or certification of financial information or data. N.Y. Educ. Law § 7401(1), (2).

Texas TEX. OCC. CODE ANN. § 901.351 states, (a) “A firm may not provide attest services or use the title “CPA’s,” “CPA Firm,” “Certified Public Accountants,” “Certified Public Accounting Firm,” or “Auditing Firm” or a variation of one of those titles unless the firm holds a firm license issued under this subchapter or practices in this state under a privilege under Section 901.461.

(a-1) A firm is required to hold a firm license under this subchapter if the firm:

- (1) establishes or maintains an office in this state; or (2) performs for an entity with its principal office in this state:
 - (A) a financial statement audit or other engagement that is to be performed in accordance with the Statements on Auditing Standards; (B) an examination of prospective financial information that is to be performed in accordance with the Statements on Standards for Attestation Engagements; or (C) an engagement that is to be performed in accordance with auditing standards of the Public Company Accounting Oversight Board or its successor.”

Example 3 in Appendix 4 to the Proposal illustrates the potential issue. Assume that Country A is outside the US and Country B is the US. The company engages a US accounting firm because state laws require the company to have the audit opinion issued by a firm licensed in the state in which that company is headquartered. The US accounting firm plans on using a network firm in Country A to perform audit procedures on the company's principal operations in Country A that would constitute substantially all of the audit procedures on the company's financial statements. We have seen situations like Example 3 when foreign businesses are acquired by a US holding company whose shares are sold in a US initial public offering.

Based on our understanding of the example, the US firm would be prohibited from being considered the lead auditor, even if the engagement partner and manager were in Country A for the duration of the audit. If our understanding is correct, it seems that in this example, in order for the company to be able to comply with state law to have its audit report issued by a firm licensed to practice public accounting in that state, the US firm would need to increase its participation in the audit in Country A.

As the Proposal observes, however, audit quality could be affected if a lead auditor performs an audit in a different country. The lead auditor may not have a full appreciation of how different business practices, cultural norms, regulations and market conditions should be addressed in the audit, and it may not be reasonable to expect the same level of country-specific experience and quality of work from members of a lead audit team outside of the country. In these cases, the other auditors may be best positioned to perform the audit procedures in the local jurisdiction.

Moreover, local laws in the foreign jurisdiction could prohibit the US firm in this example from practicing public accounting in that foreign jurisdiction. In that case, the US firm would not be able to be considered the lead auditor, and (presumably) the network firm in Country A would be considered the lead auditor. As a result, it's not clear how the company would be able to meet state law.

We generally followed the proposed amendments described in AS 2101.B2 and agree that describing a sufficiency of participation criterion in terms of risk rather than importance would be more consistent with existing PCAOB standards. The Proposal states, however, that in evaluating the sufficiency of participation, ordinarily the lead auditor would need to audit the location at which the primary financial reporting decisions were made and the consolidated financial statements were prepared in order to address the risks related to those important judgments and activities, and a sufficient number of locations to cover a greater portion of the risks than any of the other audit firms performing procedures on the audit.

The provision to audit the location at which the primary financial reporting decisions were made could result in a lack of clarity as to where the lead auditor should be located because the requirement is overly focused on the physical location. While we agree that the risks related to the consolidation and financial statement preparation, significant accounting judgments and complex accounting issues should be considered, the proposed amendments seem to appropriately weigh the coverage by the lead auditor as the key determinant in applying the sufficiency criteria. We believe these points could be made clearer in the last paragraph of Example 2.

Under current practice, AS 1205 provides that the auditor should consider whether its own participation is sufficient to enable it to serve as the principal auditor. AS 1205 allows for professional judgment, indicating that the auditor should consider, among other things, the materiality of the portion of the financial statements it has audited and the extent of its knowledge of the overall financial statements. We believe AS 1205 also enables the auditor to consider the sufficiency of its participation with the level of involvement it will have in the work performed by other auditors.

We believe that the nature, timing and extent of involvement of the lead auditor in the work of the other auditor should be driven by a risk-based approach in which the level of involvement is a matter of professional judgment and depends on factors such as (1) the significance of the location(s) audited by others to the group audit work, (2) the identified significant risks of material misstatement of the group financial statements and (3) the lead auditor's understanding of, and experience with, the other auditors. Under this approach, the lead auditor would need to be more involved with the other auditors' work based on the risks of material misstatement audited by the other auditors.

We recommend the Board explore these issues further before finalizing the proposed amendments. Although any assessment required of the lead auditor should consider whether its participation allows it to issue the report, we believe the sufficiency of its participation also should be linked to the level of involvement it will have in the work performed by other auditors. In cases where an auditor is best suited to issue the opinion and therefore serves as lead auditor but does not audit a large portion of the entity, its involvement in the work of other auditors should increase accordingly.

Registration status of other auditors

To promote compliance with PCAOB Rule 2100, the Proposal would introduce a requirement that the lead auditor determine whether the other auditor that plays a substantial role in the audit was registered pursuant to the rules of the PCAOB in order to use the work of the other auditor. This new requirement references Rule 1001 for the definition of "play a substantial role."

One of the ways that PCAOB Rule 1001 defines "play a substantial role" is through the performance of material services that a public accounting firm uses or relies on in issuing all or part of its audit report. In this context, material services means services for which the engagement hours or fees constitute 20% or more of the total engagement hours or fees, respectively, provided by the principal auditor. Information about total group audit hours and total audit fees applicable to the group audit is not typically readily available or transparent to other auditors.

Since Rule 1001 was issued, the Board has issued its audit transparency rules that require the auditor to gather information about other accountants participating in the audit. As part of that new rule, the Board provided guidance on how to measure hours related to other auditor involvement in the group audit, including permitting the use of statutory audit hours.

We believe that the Board should consider permitting the use of the hours from Form AP as a basis for determining whether an other auditor plays a substantial role in the audit. Because that information would now be publicly available, we believe it would better allow for the monitoring of whether a firm plays a substantial role to be done more consistently and efficiently. The Board might also want to consider modifying certain information requests from the PCAOB (Appendix C of the requests made to auditors preparing for PCAOB inspection) to be consistent with the suggestions above.

Definitions

The Proposal observes the use of short-term personnel-sharing arrangements, during which some personnel are seconded to other firms and function as their employees as well as other arrangements such as personnel from temporary workforce agencies that work alongside and in the same capacity as personnel on the engagement team that are employed by the lead auditor. We believe that personnel participating in these arrangements should be treated as part of the team into which they are integrated (or engaged by) because they work together with other members of the lead audit team and are under the direct supervision of that team. Similarly, when an other auditor uses short-term personnel who work with the other auditor's team, they should be considered part of that other auditor's team.

Shared service centers operate similarly. Under these arrangements, a pool of resources (that may be centralized) located in another country perform certain portions of the audit. These personnel typically operate as extended members of the team that engaged them. These personnel act under the direct supervision of the team that uses them, and that team reviews their work. In both of these examples, there are no separate workpapers maintained by the firm that employs those professionals; the work they perform is considered part of the archive of the auditor that supervised them.

We believe that the definition of lead auditor should be supplemented to include considerations in applying that definition. Individuals who are directly supervised and whose work is reviewed by the lead team (rather than just being subject to oversight by the lead team) should be considered part of the lead auditor. Examples of potential considerations in determining the lead auditor include whether:

- ▶ The audit program the individuals use to execute their procedures is the same audit program that the lead audit team uses to perform its procedures
- ▶ The individuals document their work in the same set of workpapers that will be archived together with the lead audit team's workpapers
- ▶ The results of procedures and related findings for work done by the individual are documented in the same engagement completion documents that the lead audit team creates

Risks of material misstatement

The proposed amendment to AS 2101.14 would require the lead auditor to hold discussions with and obtain information from the other auditors or referred-to auditors, as necessary, to identify and assess risks of material misstatement. As currently worded, it is unclear whether the phrase "as necessary" in the proposed amendment is intended to indicate that it may not be necessary to hold discussions and obtain information from both other auditors and referred-to auditors or whether "as necessary" means that this requirement may not apply only to referred-to auditors.

We believe that the proposed amendment to AS 2101.14 should be clarified. We also believe that the lead auditor should be able to use judgment in determining how to execute these procedures (e.g., live discussions, written communications). If the Board believes live discussions are required, we believe any final guidance should provide its expectation.

Compliance with independence and ethics requirements

The Proposal would require the lead auditor to understand the other auditors' knowledge and experience regarding SEC and PCAOB independence and ethics requirements. We generally believe that the lead auditor's procedures should be limited to inquiry of the other auditors and obtaining written confirmation from the other auditors. In our view, lead auditors should also be able to rely on their firms' system of quality control to satisfy this requirement.

For example, firms within a network may have a global code of conduct that provides a clear set of standards that guide its actions and perform procedures to monitor compliance with that code of conduct. Similarly, a firm may have global independence policies that contain the independence requirements for firms in the network, its professionals and other personnel and processes and programs aimed at monitoring the compliance with those requirements. There may also be learning requirements, including annual independence learning.

We believe that the lead auditor should have the ability to rely on quality control requirements and policies and procedures that are common within a network when the results of the underlying control procedures are frequently monitored by the firm and reported to engagement teams, and specific actions are taken by firm leadership to address weaknesses identified. Privacy laws, which restrict personnel information from being shared, may also require lead auditors to place more reliance on a firm's system of quality control.

We believe this concept should be included in any final guidance.

Qualifications of other auditors

We believe that the lead auditor should seek responses to its inquiries and obtain written confirmations from the other auditors about their knowledge, skill and ability, but should not need to assess the training programs of other auditors. This is another area in which an acknowledgement that multinational network firms may leverage the information available within their networks to provide a basis to rely on their systems of quality control would be helpful.

AS 1201, Supervision of the Audit Engagement

We support the proposed amendments that would require the lead auditor to communicate to other auditors the scope of work, tolerable misstatement and, if determined, the amount below which misstatements are clearly trivial and do not need to be accumulated. These communications are commonly made in practice.

We believe that the proposed requirement to communicate identified risks of material misstatement, however, is too broad because auditors typically identify these risks as part of their work to understand each significant class of transactions and perform walkthroughs, and the risks are identified at an assertion level. This detailed assessment is performed on each component of a multilocation audit, and the lead audit team may not be best suited to perform the procedures necessary to identify risks of material misstatements for every component.

We suggest that the requirement for communication of risks of material misstatement be narrowed to require the communication of significant risks of material misstatement and other risks of material misstatement that are relevant to the work of the other auditor, rather than all risks of material misstatement.

Similarly, we believe the proposed requirement to review the description of the nature, timing and extent of the procedures performed by other auditors should be risk-based so lead auditors can focus on areas or components with higher risk rather than all areas of work performed by all other auditors. Furthermore, to provide for consistent application, it would be helpful for the Board to include guidance about whether this requirement is intended to be a detailed review of the other auditors' audit programs or whether, in most circumstances, a review of a summary level description, such as a summary level planning memorandum, might be appropriate.

Finally, we believe that adding paragraph .B3 to AS 1201 that would require lead auditors to directly inform all other auditors of the scope, tolerable misstatement, risks of material misstatement and amount below which misstatements are clearly trivial (the .B2a requirements) would result in an inconsistent structure of communications between first other auditors and second other auditors (i.e., inconsistent with the communication flow for other phases of the audit). This may have an unintended consequence to audit quality.

In many multi-tier audit arrangements, the first other auditor (i.e., rather than the lead auditor) provides all communications, including the .B2a requirements, to the second other auditor. This is because the first other auditor has primary responsibility for all communications with the second other auditor. Evaluation of the reporting provided by the second other auditor is performed by the first other auditor, and the related communications occur directly between these other auditors. The basic communication structure should be consistent for all communications between other auditors.

We recognize that the lead auditor is responsible for the overall audit and, therefore, may need to understand both the scope and results of work performed by second other auditors as part of its supervision of the first other auditors. The lead auditor may therefore decide to be involved directly as necessary (e.g., by attending a conference call to understand results discussed by the first and second other auditors). However, we believe the responsibility for the direct communications with the second auditor is best placed with the first other auditor. The first other auditor is responsible for its work product to the lead auditor, which includes all work of the second other auditor. We believe that the lead auditor, in turn, should follow the standards for supervision and review of the first other auditor described in the Proposal. As a result, we don't believe that having two sets of communications and duplicative oversight should be required.

In response to several of the Proposal's questions about responsibilities, we believe that the reporting provided by the other auditor to the lead auditor plays a significant role in communicating the other auditor's responsibilities. However, there is no guidance on the content and format of reports provided by other auditors, and there is currently a wide divergence in practice as to the form and content of these reports. If the Board has a view, it would be helpful for any final guidance to include a description of the content and format of inter-firm reports to promote consistency in practice.

AS 1220, Engagement Quality Review

We believe the proposed requirement that the EQR evaluate the engagement partner's determination that the participation of his or her firm is sufficient to carry out the responsibilities of a lead auditor should be risk-based. We believe that the EQR should be required to evaluate that determination only when it is concluded to be a significant judgment, which would be more aligned with the Proposal's risk-based approach. Because AS 1220.09 currently requires the EQR to evaluate the significant judgments made by the engagement team and the related conclusions reached, we don't believe the current requirements in AS 1220.09 need to be amended.

AS 1215, Audit Documentation

The Proposal would add a requirement that the audit documentation of the office issuing the auditor's report contain a list of additional workpapers of other auditors that were reviewed but not retained by the lead auditor. We suggest that the PCAOB clarify whether it would expect the lead auditor to review all significant workpapers of other auditors. If so, such a requirement could lead to additional levels of review that increase costs without providing significant improvements to audit quality.

A requirement to review all significant workpapers also has the potential to distract the lead auditor and result in a less-effective mix of procedures being performed by the lead auditor. For example, the lead auditor may review workpapers rather than hold more live discussions with the other auditor. We believe that any requirement to document workpapers that were reviewed but not retained should be in the context of documenting which procedures were performed out of the various options available to the lead auditor to be adequately involved in the work of other auditors.

We believe a more appropriate requirement is for the lead auditor to document how it has been adequately involved in the work of other auditors. That documentation could include the overall involvement of the lead auditor (e.g., communications, workpaper reviews, discussions) in the work of other auditors. We believe that providing a more principles-based objective – rather than a prescriptive requirement to document the specific workpapers reviewed – would better demonstrate the lead auditor's supervision and review.

We believe that a more principles-based approach would also better address a potential issue when other auditors are required to maintain their documentation in a language that is different from the lead auditor's documentation language. Some jurisdictions require statutory audit documentation to be maintained in the local language. By providing a more principles-based approach in this area, the lead auditor can perform a variety of procedures (which may include some workpaper review) to provide for an appropriate level of involvement.

If the Board decides to require the lead auditor to document the specific workpapers reviewed, we believe the description of the workpapers should be limited to the workpaper reference and title of the workpaper reviewed. Creating a summary description of the nature of the workpaper would create several practical challenges for the lead auditor, especially lead auditors dealing with a number of other auditors. For example, given the nature of this documentation, much of it would occur during year end, which is time constrained. In addition, the lead auditor would presumably need to review the final version of each workpaper. As the review process is iterative, the lead auditor may not have sufficient time to re-review final versions of the respective workpapers before the report release date.

We support the Board's decision not to require the lead auditor to include a list of all documents in the other auditor's files. As previously discussed, there are a number of procedures a lead auditor can perform in order to be adequately involved in the work of other auditors.

We do not believe amendments to AS 1215 that would require the lead auditor to obtain documentation supporting the other auditor's work regarding related parties and significant transactions are needed given the documentation requirements of AS 2410, *Related Parties*. A next step for the Board could be to assess the implementation of AS 2410 and only make adjustments if it appears that additional review is required.

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

We support the Board's approach of proposing a separate standard on dividing responsibility in an audit, and support updating the requirements in this area.

We believe that the Proposal could result in an increase in opinions where the lead auditor refers to another auditor, especially in countries where audit firm rotation is mandatory. The proposal could also result in references to auditors within the same multinational network firm. The additional references to other auditors, particularly those in the same multinational network firm, could be confusing and diminish investor confidence.

We generally believe that dividing responsibility for the audit should occur only in certain circumstances that should be provided for in the guidance. AS 1205 currently provides guidance on when the principal auditor may be able to express an opinion without making reference to the audit of the other auditor. It specifically indicates that the principal auditor would ordinarily be able to express an opinion without making reference to the audit of the other auditor when part of the audit is performed by an auditor that is an associated or correspondent firm and whose work is acceptable to the principal auditor based on its knowledge of the professional standards and competence of that firm.

However, the Proposal would not carry forward the guidance in AS 1205 on when to make reference. We believe that retaining the presumptive language that the lead auditor would not make reference to another auditor in the same multinational network firm described in AS 1205.05a would enable lead auditors to continue to apply professional judgment and reduce the potential for an increase in opinions where the lead auditor refers to an other auditor.

The Proposal would not allow a lead auditor to divide responsibility when the financial reporting frameworks are different. Currently, paragraph .26 of AU-C Section 600, *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)*, allows for such division of responsibility, provided that the measurement, recognition, presentation and disclosure criteria of the financial reporting framework used by the component are similar to the financial reporting framework used by the group and the lead auditor has obtained sufficient appropriate audit evidence to evaluate the adjustments to convert the component's financial statements to the financial reporting framework used by the group. We believe this provision that allows a lead auditor to divide responsibility when the financial reporting frameworks are different has worked in practice and should be retained.

Proposed paragraph .07 of AS 1206 describes what the lead auditor should do in situations in which the lead auditor is unable to divide responsibility. We believe paragraphs .07a-c are designed to be mutually exclusive options. That is, a lead auditor either (1) plans and performs procedures necessary to issue an opinion without referring to an other auditor, (2) qualifies or disclaims an opinion or (3) withdraws from the engagement. If our understanding is correct, we believe the word "or" is needed at the end of paragraph .07a.

Finally, the Proposal does not address joint audits. Although it appears that certain of the Proposal's provisions are consistent with how many joint audits are conducted in practice, there are unique aspects of joint audits that we believe should be addressed in any final guidance.

Considerations in using a service auditor's report

It wasn't clear to us whether the proposed amendments to paragraph 19 of AS 2601 are designed merely to remove the cross reference to AS 1205, which would be superseded by the Proposal, or instead to suggest that the auditor should be performing the procedures described.

The information provided in service auditor's reports is carefully designed to be detailed enough to address the needs of substantially all user entities and their auditors because, in most cases, it is highly impractical for the organization and its auditors to individually support the needs of each of the respective user entities and their auditors. Moreover, reviewing the service auditor's audit program and issuing instructions to the service auditor as to the scope of the audit work would effectively eliminate the benefit of using a service auditor's report. As a result, we generally believe it would be rare for an auditor to perform the procedures described.

It would be helpful for the Board to include guidance in the final release to clarify whether a change in practice is expected as a result of the amendment to paragraph 19 of AS 2601.

Emerging growth companies

We do not think that audits of emerging growth companies (EGCs) should be excluded from the Proposal because we believe EGCs have characteristics similar to other public companies.

* * * * *

We would be pleased to discuss our comments with the Board or its staff at your convenience.

Very truly yours,

The image shows the handwritten signature of Ernst & Young LLP in black ink. The signature is written in a cursive, flowing style, with the letters 'E' and 'Y' being particularly prominent and stylized.

cc:

PCAOB

James R. Doty, Chairman
Lewis H. Ferguson, Board Member
Jeanette M. Franzel, Board Member
Jay D. Hanson, Board Member
Steven B. Harris, Board Member
Martin F. Baumann, Chief Auditor

SEC

Mary Jo White, Chair
Michael S. Piwowar, Commissioner
Kara M. Stein, Commissioner
James Schnurr, Chief Accountant
Wesley R. Bricker, Deputy Chief Accountant
Brian T. Croteau, Deputy Chief Accountant
Julie Erhardt, Deputy Chief Accountant



Federation of European Accountants

Office of the Secretary
PCAOB

Sent by email:
comments@pcaobus.org

Brussels, 26 July 2016

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

Dear Sir or Madam,

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

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

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

Kind regards,

On behalf of the Federation of European Accountants,



Petr Kriz
President



Olivier Boutellis-Taft
Chief Executive

About the Federation of European Accountants

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

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

Annex: Responses to Questions

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

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

Question 3: Discussion of Proposed Amendments

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

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

Questions 4-12: Economic Analysis

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

Question 13: Considerations for Audits of Emerging Growth Companies

- (14) Nothing to report.

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

- (15) Nothing to report.

Question 15: Effective Date

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

Questions 16-59: List of Appendices**Questions 16-20: Terminology – Proposed Definitions**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

- (42) Nothing to report.

Questions 53-54: Other Considerations

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

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

- (44) Nothing to report.

July 28, 2016

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

Electronically submitted: comments@pcaobus.org

Re: PCAOB Rulemaking Docket Matter No. 042: Proposed Amendments To The Supervision of Audits Involving Other Auditors; and Proposed Auditing Standard - Dividing Responsibility for the Audit with another Accounting Firm

Dear Sirs:

The Accounting Principles and Auditing Standards Committee (the Committee) of the Florida Institute of Certified Public Accountants (FICPA) respectfully submits its comments on the referenced proposal. The Committee is a technical committee of the FICPA and has reviewed and discussed the above referenced proposed auditing standard. The FICPA has approximately 20,000 members, with its membership comprised primarily of CPAs in public practice and industry. The Committee is comprised of approximately 20 members, of whom 50% are from local or regional firms, 22% are from large multi-office firms, 17% are sole practitioners, and 11% are in international firms.

We fully agree with the Board's objectives to strengthen the existing requirements and impose a more uniform approach to the lead auditor's supervision of other auditors, as described in the proposed standard. Overall there was general agreement with the proposed auditing standard; however, we would also like to include responses to questions 7, 13, and 15 below:

1) Response to Question 7

The Committee agrees that those audit firms not currently complying with the proposed standards may incur higher costs to implement the proposed audit requirements. However, we believe that most PCAOB registered firms, if not all, also perform non-issuer audits and therefore are required to comply with Generally Accepted Auditing Standards (GAAS). Since the proposed audit standards are already incorporated within the GAAS requirements, the incremental increase in cost should not be prohibitive.

2) Response to Question 13

The Committee believes the proposed audit standard should apply to all audits regulated under PCAOB, with no exceptions made for any particular industry.

3) Response to Question 15

The Committee believes the PCAOB should allow 1 year following SEC approval for accounting firms to implement the proposed audit requirements.

The Committee appreciates this opportunity to respond to the proposed auditing standards. Members of the Committee are available to discuss any questions or concerns raised by this response.

Respectfully submitted,

Ed Cranford CPA, Chair
FICPA Accounting Principles and Auditing Standards Committee

Committee members coordinating this response:

Rosi Gonzalez, CPA
Steven Bierbrunner, CPA



July 29, 2016

Office of the Secretary
Public Company Accounting Oversight Board
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Via Email to comments@pcaobus.org

Re: PCAOB Rulemaking Docket Matter No. 042: Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Accounting Firm

Dear Board Members and Staff:

Grant Thornton LLP appreciates the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or Board) *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Accounting Firm* (Proposal). Overall, we are supportive of the project and agree with the determination that current professional standards regarding the use of other auditors should be subject to outreach and enhancements.

As noted in the Proposal, changes in the business environment, firm structures, financial reporting standards, and regulatory reporting requirements have all contributed to the need to revisit current standards. In addition, many firms, including ours, have revised their methodologies in response to the adoption of group audit standards promulgated by the International Audit and Assurance Standards Board (IAASB) and Auditing Standards Board (ASB). The comparisons highlighted in the Proposal between the potential PCAOB standards and the existing IAASB and ASB standards are helpful in evaluating areas of potential differences.

We view the incremental interaction between the lead auditor and other auditors outlined in the Proposal as a valuable benefit, but it is important to emphasize that the nature, timing, and extent of any required interaction needs to be risk-based and scalable in consideration of the significance of the risks of material misstatement specific to the consolidated financial statements and/or accounts or classes of transactions being audited by the other auditor. We believe the need for the standards to continue to allow flexibility for firms in managing circumstances involving the use of other auditors is critically important. This includes the use of network firms, seconded employees, and shared service centers. We believe that the Proposal seeks to maintain that flexibility while at the same time building in more consistency in certain areas of the standards.

We commend the Board for their approach in the context of the preceding comments. We respectfully submit our comments and recommendations, which are focused on aspects of the Proposal that may benefit from further clarity or on potential unintended consequences related to certain requirements that might be counter to the objectives noted above.

Economic impact

We generally agree with the characterization of current practice described in Section II.B of the Proposal. Many larger and medium-sized firms have adopted a methodology that is based on International Standards on Auditing 600 and AU-C Section 600, *Special Considerations – Audits of Group Financial Statements, Including the Work of Component Auditors* (ISA 600 and AU-C 600, respectively). Those methodologies are intended to comply with both PCAOB Auditing Standard 1205, *Part of the Audit Performed by Other Independent Auditors* (AS 1205), requirements and the ISA/AU-C standards. As noted in the Proposal, this may result in audit procedures that go beyond the current AS 1205 requirements. While some firms may go beyond current PCAOB standards, certain of the procedures are based on facts and circumstances of the engagement and may be dependent on factors such as risk of material misstatement, location of the components, locations being audited by other auditors, presence of U.S. firm seconded resources, etc.

Accordingly, we see potential for the Proposal to have a greater impact on the profession, even on the larger firms with enhanced methodologies, due to the fact that certain proposed requirements may result in a more prescriptive approach, particularly in the context of required communications and documentation that may be needed to evidence compliance with the Proposal. Therefore, we are concerned with the staff's generalization that the Proposal will not have a significant impact on all firms, even those with enhanced methodologies, because:

- The proposed requirements will likely result in a broader impact to larger and/or more networks (irrespective of size of audit firm) due to the specificity of certain of the proposed requirements.
- There could be different implications and a lack of consistency in the application of the proposed amendments and standard based on how networks and firms are structured
- Firms have adopted or exceeded current requirements considering the risk management approach adopted by a particular firm

We would also observe that the linkage between increased work and/or costs and increased audit quality is not clear (for example, not all proposed requirements appear to be scalable based on assessed risks). We have highlighted in the remainder of this letter certain proposed requirements that we believe should be clarified with respect to risks and scalability to help more clearly delineate that any increase in cost is commensurate with an increase in audit quality.

Potential operational challenges and unintended consequences

Independence and qualifications of other auditors

We believe the Proposal generally reflects current practice of the larger firms, and we agree that ongoing communications so that the lead auditor can assess changes in circumstances promotes

audit quality. However, we believe certain proposed requirements would benefit from greater clarity as to the Board's intent.

The Proposal now includes other auditors in the definition of the engagement team; therefore, the lead auditor is required to assess the knowledge, skill, and ability of *each* engagement team member (among other things) in determining the nature, timing, and extent of the lead auditor's review. It is unclear how the lead auditor may vary their review of the other auditor's work based on the results of that assessment. Most notably, we believe the lead auditor should have the ability to consider and, where appropriate, rely on a network firm's system of quality control in determining the nature and extent of the assessment. Because the Proposal does not acknowledge or distinguish between network firms and unaffiliated firms, we anticipate incremental effort and costs when the lead auditor uses a network firm as the other auditor. The incremental effort would not result in a commensurate increase in audit quality in those circumstances. We strongly encourage the Board to provide better scalability relative to network firms versus unaffiliated firms, since we believe network firms currently rely on the system of quality control when assessing compliance with independence and ethics requirements as well as on continuing education and adherence to firm policies. We also suggest it would be beneficial to note that for continuing audits, past experience with the other auditor personnel would be a factor in evaluating the amount of supervision appropriate in the circumstances.

We note that it is unclear how the lead auditor would be expected to respond to contradictory evidence (for example, negative quality indicators such as an other auditor being sanctioned by the SEC for an independence violation). The lead auditor may have difficulty concluding how the contradictory evidence might impact the assessment of their ability to use the work of the other auditor specific to an individual engagement. Further exploration of this area would be beneficial.

Sufficiency

We appreciate the examples provided in the Proposal regarding determination of sufficient participation. However, the underlying notion of "participation" is subject to interpretation and could result in inconsistent execution. It's possible that firm size and structure may drive the lead auditor determination; a firm comprised of more individuals may have an easier time demonstrating "sufficient participation," which could put smaller firms at a competitive disadvantage. We acknowledge that the proposed requirements are intended to be risk-based, but the related discussion on page A4-15 of the Proposal implies a focus on a coverage approach driven by quantitative benchmarks.

There also does not appear to be consideration given to situations where the lead auditor is heavily involved in the work of the other auditor. In current practice, there may be instances where the lead auditor is so involved that the other auditor becomes a mere extension of the lead auditor's engagement team. In such a case, the lead auditor might be considered to have "sufficient participation" even though an other auditor is technically involved.

Reporting by other auditors

We are concerned by the lack of clarity provided in the Proposal regarding the reporting that would take place in accordance with proposed AS 1201.B2d, which states the lead auditor "obtain

from the other auditor a written report describing the other auditor’s procedures, findings, conclusions, and, if applicable, opinion.” Current reporting practice varies considerably and depends on a variety of factors, such as to whom the other auditor is reporting (for example, network firm or unaffiliated firm) and the extent of involvement of the other auditor.

Oftentimes, a more formal report is provided to the lead auditor by the other auditor when it is an unaffiliated firm. Network firms, on the other hand, generally provide documents more closely resembling an engagement completion document along with the necessary workpapers. We also note that conventions for reporting to unaffiliated firms, developed and adopted by certain of the firms with the larger global firm networks, indicate that the other auditor’s report would be qualified if the lead auditor directs the other auditor not to perform certain procedures required by the auditing standards or if the scope of the audit is limited (for example, goodwill at the subsidiary is tested for impairment by the parent; thus, the lead auditor would handle auditing this balance and related impairment assessment).

The involvement of an other auditor can range from performing an offsite inventory observation to a comprehensive audit of the component’s financial statements. It is unclear what the PCAOB’s expectations are relative to reporting in situations that fall within that spectrum, or if the intention is to leave the form of reporting to the judgment of the lead auditor depending on the circumstances. For example, when audit procedures are limited to certain accounts or classes of transactions, a report resembling an agreed-upon procedures report may be deemed appropriate. We believe interfirm reporting currently experiences operational challenges; thus, this is an opportunity for the PCAOB to provide clear and scalable guidance with regard to acceptable forms of reporting. We ask the Board to consider clarifying the expectations with respect to reporting requirements and, if more consistency of reporting is a desired outcome, providing report examples. Such examples could be based on (i) the extent of work performed by the other auditor (for example, a report on specified procedures and findings or an opinion that implies some level of assurance), and (ii) the nature of the relationship between the lead auditor and other auditor.

Lead auditor communications, supervision, and review

We are supportive of the proposed requirement to communicate scope, tolerable misstatement, and trivial amounts in writing. However, the proposed requirement at AS 1201.B2b regarding the lead auditor’s review of the other auditor’s planned audit approach does not appear to be risk-based. We believe the lead auditor should be able to focus on significant risks and key workpapers that address risks of material misstatement. We also believe communicating *any* change to audit procedures in writing is overly burdensome and does not align with a principles-based approach. We agree that having written documentation of the communications will be beneficial to audit quality, but we encourage the Board to consider revising these requirements to make them more risk-based and scalable.

Definitions

We are supportive of the PCAOB driving consistency in practice through defining terms such as “engagement team,” “lead auditor,” and “other auditor.” Nevertheless, we are concerned about how operational the definition of “lead auditor” will be in contemplation of short-term personnel

sharing arrangements, longer-term secondments, and contractors, since the definition states that individuals are part of the lead auditor only if they are “employees of the registered accounting firm signing the auditor’s report.” This could lead to inconsistencies in practice depending on how firms legally structure these types of arrangements. We recommend the Board consider expanding the definition to include engagement team members that work alongside or in the same capacity as employees of the lead auditor. This will provide a more principles-based approach and allow firms to apply it with these types of employment arrangements.

Audit documentation

We are concerned about proposed AS 1215.19A regarding the lead auditor’s documentation including a list of additional workpapers of other auditors that were reviewed but not retained by the lead auditor. We believe that while the intent would be to evidence the depth of the review, the tracking of all workpapers that were looked at is overly burdensome. The review process is dynamic, and the proposed requirement implies that the lead auditor would have to inventory every single workpaper they happen to open or refer to during that review process, in addition to documenting a description of the workpaper, who reviewed it, and when that review took place. We believe the requirement that the workpapers be accessible to the lead auditor is sufficient from a documentation perspective and encourage the Board to reconsider the cost/benefit of implementing such a prescriptive requirement.

Other auditors’ responsibility for their own work

In reviewing the Proposal compared to the extant AS 1205, we noted certain text that is no longer captured in either the proposed amendments or standard. Specifically, we call attention to AS 1205.03, which states, in part, “Regardless of the principal auditor’s decision [whether to make reference to an other auditor in the auditor’s report], the other auditor remains responsible for the performance of his own work and for his own report.” We are supportive of the Board’s endeavor to improve quality and accountability of the lead auditor when supervising and using the work of other auditors. However, this should not diminish the expectation that the other auditor should also be expected to remain responsible for the quality of their work. We believe omitting this notion from the Proposal could imply a “free pass” to other auditors regarding the quality and sufficiency of their work.

Dividing responsibility for the audit

We commend the Board for proposing a separate standard when dividing responsibility for an audit with another accounting firm. While we acknowledge that instances of dividing responsibility are rare in issuer audits, we believe the profession will benefit from having all relevant requirements in one standard. We are also supportive of the proposed definitions; separating “referred-to auditor” and “other auditor” provides greater clarity to both roles and how the auditing standards apply to each.

We note, however, instances where extant language in AS 1205 was not included in proposed AS 1206, and we believe there are potential unintended consequences by not carrying over that language. Currently, a firm generally does not make reference to another firm in its global network. We believe the omission of guidance such as AS 1205.05-06 from a proposed standard would indicate that such considerations are no longer appropriate, resulting in a change in

practice. The profession will continue to face scenarios where it may be impractical for the lead auditor to take responsibility for the other auditor's work. Therefore, we ask the PCAOB to consider including these extant paragraphs in the proposed AS 1206.

The Proposal also does not allow for division of responsibility when financial reporting frameworks are different. We believe this may also create a change in practice since AU-C 600 allows for such division if certain requirements are met (AU-C 600.26). This is an important option that should be afforded to auditors under PCAOB standards (consider, for example, an equity investee where the financial statements are prepared using IFRS). We encourage the Board to also consider addressing and allowing for such situations in proposed AS 1206.

Applicability and effective date

We agree with staff observations that the use of other auditors in audits of broker-dealers is not common. However, we believe it will benefit audit quality in all PCAOB audits to apply a more updated, risk-based and principles-based approach to the use of other auditors. Therefore, we believe the Proposal should apply to broker-dealers and emerging growth companies.

With regard to the effective date, we believe auditors will need at least one year to coordinate and execute the proposed amendments and standard, since planning for large, international engagements begins very early in the audit process. Therefore, firms will need time to update audit methodologies and tools on a timeline that enables engagement teams to apply the new requirements from the beginning of the audit.

We would be pleased to discuss our comments with you. If you have any questions, please contact Trent Gazzaway, National Managing Partner of Professional Standards, at (704) 632-6834 or Trent.Gazzaway@us.gt.com.

Sincerely,





July 29, 2016

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: PCAOB Rulemaking Docket No. 042

Dear Board Members:

The Audit and Assurance Services Committee of the Illinois CPA Society (“Committee”) is pleased to comment on the PCAOB’s Proposed Amendments Relating to the *Supervision of Audits Involving Other Auditors and Proposed Auditing Standard - Dividing Responsibility for the Audit with Another Accounting Firm* (Docket Matter No. 42), dated April 12, 2016. The organization and operating procedures of the Committee are reflected in the attached Appendix A to this letter. These comments and recommendations represent the position of the Illinois CPA Society rather than any members of the Committee or of the organizations with which such members are associated.

GENERAL COMMENTS:

As a Committee, we agree with efforts made by the PCAOB and believe the proposed amendments to AS 1205 as well as the new proposed auditing standard AS 1206 are needed to help drive audit quality. Our response is limited to the following questions.

PCAOB QUESTIONS:

Question 1:

Does the description of existing audit practice accurately depict the state of practice? Does the discussion of the reasons to improve auditing standards sufficiently describe the nature of concerns arising from the use of other auditors that the Board should address? Are there additional concerns that the Board should seek to address?

Response:

We believe the description of existing audit practice is accurate. We also believe that the discussion of the reasons to improve auditing standards as it relates to the Use of Other Auditors sufficiently describes the current nature of concerns the Board should address. The original standard was issued in 1979 and updated in 1996, however, with the increase in corporate globalization and the use of other auditors, this amendment should improve audit quality.

Question 2:

Are these proposed amendments to existing standards appropriate? Are additional changes needed to increase the likelihood that the lead auditor is sufficiently involved in the other auditor's work? Should the Board require specific procedures to address business, language, cultural, and other differences between lead auditors and other auditors, and if so, what types of procedures?



Response:

Yes, we believe the proposed amendments are appropriate and should improve audit quality. We believe the changes to increase the lead auditor's involvement are appropriate.

Question 6:

The Board requests comment generally on the potential benefits to investors and the public. Are there additional benefits the Board should consider?

Response:

We believe the proposed amendments will provide more transparency when using other auditors and will, therefore, benefit investors and the public.

Question 8:

The Board requests comment generally on the potential unintended consequences of the proposal. Are the responses to the potential unintended consequences discussed in the release adequate? Are there additional potential unintended consequences that the Board should consider? If so, what responses should be considered?

Response:

We believe there could be other unintended consequences beyond what is discussed in the proposed standard. For example, if the lead auditor does not have a network firm in a particular country and needs to consider the use of the statutory auditor in the audit; if the statutory auditor is not registered with the PCAOB, the lead auditor may need to send his/her engagement team to the country to complete the audit. These additional procedures could increase the cost of the audit.

Question 9:

Could the proposed requirement for lead auditor supervision diminish (or be perceived as diminishing) the other auditor's accountability for the work the other auditor performs? If so, are any changes to the proposal needed to describe the other auditor's responsibilities?

Response:

Typically, the lead auditor will ask the other auditor to issue a "report", so we would not say it diminishes the "other auditors" accountability over their own work. From the Board's release, you have seen evidence that with increased supervision and direction given to the other auditor, there was an increase in the quality of their work. We believe the perception would be that the other auditor's work would improve due to the increased supervision by the lead auditor.

Question 10:

Could the proposed requirement for lead auditor supervision induce lead auditors in some audits to divide responsibility with another accounting firm rather than supervise the accounting firm? If so, how often might this division of responsibility occur?



Response:

Yes, if the other firm is a great distance apart and close supervision cost-prohibitive, this could induce the lead auditor to divide responsibility, by referring to the other auditor in their report. In addition to being cost prohibitive, there is also the matter of completing all the work to a strict deadline. The lead auditor may physically not be able to do all their work here in the US, “closely supervise” firms in other countries and still meet strict deadlines. If the lead firm is already performing additional procedures, they are less likely to divide responsibility.

Question 14:

The Board requests comment generally on the analysis of the impacts of the proposal on audits of brokers and dealers. Are there reasons why the proposal should not apply to audits of brokers and dealers? Are there any factors specifically related to audits of brokers and dealers that should affect the application of the proposal to those audits?

Response:

We believe that Brokers and Dealers should follow the same standards as issuers.

Question 16:

Are the proposed definitions of: (a) "engagement team," (b) "lead auditor," (c) "other auditor," and (d) "referred-to auditor" appropriate? Do the proposed definitions clearly describe individuals and entities that are included in these definitions? Is it clear which individuals or entities are not included in these definitions? If not, what changes to the proposed definitions are necessary?

Response:

Yes. See question #17, for specific revision to “lead auditor”

Question 17:

Some global network firms use short-term (several months) personnel sharing arrangements, during which some available personnel are seconded to other firms and function as their employees. Some firms contract with consulting firms or temporary workforce agencies for personnel that work alongside and in the same capacity as personnel on the engagement team that are employed by the lead auditor. Should these personnel be treated as part of the lead auditor?

Response:

Yes, if these personnel are supervised by the lead auditor, working out of their location, and their work is reviewed by the lead auditor, these team members should be treated as personnel of the lead auditor. Page A1-21, Appendix A .A3, a (1), uses the phrase: “professional staff employed or engaged by”. It may be helpful to include a footnote to explain the breadth of the meaning of the term “other auditor”, as explained in your question.

Question 19:

Should there be requirements for the lead auditor to: (1) specifically identify the engagement team members responsible for assisting the engagement partner of the lead auditor in fulfilling his or her supervisory



responsibilities and (2) document such assignments? Should the individuals who assist the engagement partner with supervision be limited to engagement team members from the office issuing the auditor's report?

Response:

Yes, documentation should include engagement team members and their roles in the engagement. The office issuing the report should not be required to be the only office “supervising” staff in other countries. “Supervision” is a broad term, and we believe it also covers direct supervision in that country. The lead auditor could also “remotely supervise” by other means which includes direct review of high risk area work papers.

Question 20:

To emphasize the importance of assigning the proposed planning and supervision requirements to personnel with the appropriate qualifications in audits involving other auditors, the proposed definition of "lead auditor" references existing standards that describe making appropriate assignments of engagement responsibilities. Does this reference appropriately address the responsibility to seek planning and supervision assistance from qualified engagement team members in these situations?

Response:

This question was deemed to have a certain element of ambiguity. Specifically, it’s unclear whether the Board is seeking comment on situations in which the engagement partner assigns planning or supervisory requirements to an individual within his or her firm to bridge language or cultural differences or whether it’s specific to the engagement partner’s direct oversight of other auditors.

If the former, then we advise the following:

The definition or its footnotes should include discussion of the lead auditor engagement partner’s need to consider the assignee’s requisite familiarity with the industry in which the company operates, as well as the language and cultural norms of the other auditor.

We feel this clarification is necessary to ensure an engagement partner identifies resources within his or her firm that are not only proficient in the local language and cultural norms, but also familiar with accounting issues and audit risks within the relevant industry to be able to identify and communicate deficiencies to the engagement partner.

If the latter, then we advise the following:

Paragraph .B6 in Appendix B (Page A1-14 of Release No. 2016-002) should either be referenced or incorporated into the definition of lead auditor. In other words, we feel the definition should be clear with respect to the engagement partner’s need to consider the other auditor’s experience in the industry in which the company operates, as well as their knowledge of the relevant financial reporting framework, PCAOB standards and rules, SEC rules and regulations, and their experience in applying the standards, rules, and regulations. The engagement partner should also determine whether he or she can adequately communicate with the other auditors and/or gain access to their work papers.

Regardless of the Board’s intent with this question, we feel clarification is warranted within the proposed definition of “lead auditor” to further reinforce the consideration of language and cultural norms inherent in any audit which includes other auditors.



Question 21:

The proposed requirements for determining whether a firm's participation is sufficient for it to serve as the lead auditor depend on the risks of material misstatement associated with the portion of the financial statements audited by the firm. (These requirements would apply regardless of whether the other auditor is from the same audit network as the lead auditor.) Should the Board consider alternative or additional criteria for determining whether a firm's participation is sufficient? For example, should the Board impose a quantitative threshold or specify criteria covering the locations of the company's principal assets, principal operations, or corporate offices? How would such criteria help address specific issues in practice?

Response:

The firm's consideration of its direct audit coverage over the risks of material misstatement appears an appropriate determination for evaluating the sufficiency for the firm to serve as lead auditor. The proposed language appears intentionally broad so as to allow for the many varying situations and circumstances, as well as variables that are considered in such a determination, and appropriately allows for auditor judgment in its final assessment.

While the Board could consider offering additional criteria for auditor consideration when making this determination, we feel that if the language is too specific (which can arise when quantitative thresholds are added) it can restrict appropriate analysis of the qualitative factors involved when making such a determination. If a coverage threshold requirement of a certain level of locations, total assets or revenue is communicated, an appropriate analysis of the true risks of material misstatement could be diminished. For example: there certainly could be situations where a significant portion of the company's assets may be audited by another auditor because they are located in a foreign jurisdiction due to the location of the company's manufacturing process; however the company's US based operations (covered by the lead auditor) contain significant revenue streams requiring complex accounting (multiple deliverables, licensing, etc.) and therefore house the most significant risks of material misstatement. Thus, a threshold of certain levels of assets directly audited by the lead auditor may be seen as overshadowing the consideration of the true coverage of auditing the significant risks of material misstatement.

We believe that while certain consideration language in the proposal may assist the firm in determining sufficiency, additional criteria or thresholds could result in unintended conclusions or outright violations of standards.

Question 22:

What are the practical challenges with applying the proposed engagement partner's determination of the firm's sufficiency of participation in the audit? What changes, if any, should be made to address those challenges?

Response:

The primary practical challenge with applying the proposed engagement partner's determination of the firm's sufficiency of participation in the audit lies primarily with adequate documentation of auditor judgment. Whenever leeway for auditor judgment is given, there is the potential for different applications and varying conclusions. In addition, objective judgment is obviously affected by the desire to serve as the lead auditor. However, in most areas this judgment is necessary because of the numerous variables that must be considered and also due to the fact that no situations and circumstances are exactly alike.

The Board could consider a documentation requirement where the firm qualitatively assesses the positive and negative evidence of the firm's sufficiency to serve as the lead auditor, which includes conclusion and clear basis



for such a conclusion. This documentation could be prepared as part of the engagement acceptance process and maintained in the audit file.

Question 23:

Are there situations in practice in which the proposed sufficiency determination would cause changes in the firm serving as lead auditor? If so, what are these situations? What are the potential effects of those changes, including potential effects on costs and audit quality? What changes to the proposal, if any, would mitigate these issues?

Response:

As proposed, the sufficiency determination could result in changes in the firm serving as lead auditor if the current level of involvement by the lead auditor is determined to be inadequate under the new standard. This could result in increased costs incurred by the lead auditor. Particularly, if increased involvement by the lead auditor replaces work performed by local auditors, the added travel time and potentially higher rates would result in higher costs and fees. Alternatively, if a change in lead auditor is required, the company will bear the incremental costs of such a transition.

In regards to audit quality, increased involvement by lead auditors should, in theory, improve audit quality. There is the potential, however for the lead auditor to continue to limit its involvement. Due to fee pressure invoked by the company, there is the potential that the lead firm may try to keep these costs to a minimum and, as a result, not audit as thoroughly as another auditor might.

Question 25:

Are the proposed requirements for the lead auditor to hold discussions with and obtain information from other auditors and referred-to auditors to identify and assess the risks of material misstatement appropriate and clear? Are there any practical challenges with this requirement? If so, what are they, and how could the proposed requirements be revised to address the challenges?

Response:

We believe the proposed requirements for the lead auditor to hold discussions with and obtain information from other auditors and referred-to auditors are appropriate and clear, as well as prudent. The lead auditor should establish early, and maintain throughout, clear lines of communication with all other auditors participating in the audit.

Question 26:

Are the additional proposed requirements for the lead auditor when planning an audit that involves other auditors, which address independence and ethics; registration; and qualifications of and communications with other auditors, appropriate and clear? Are there requirements that should be added to or removed from Appendix B of AS 2101? If so, what are those requirements and why should they be included or excluded?

Response:

We believe the additional proposed requirements for the lead auditor when planning an audit that involves other auditors are appropriate and clear, as well as prudent. These activities should be adequately documented within the audit files.



However, we also note that some out-of-network other auditors might be reluctant to provide the lead audit firm with details regarding local independence, ethics, or training.

Question 27:

The proposed amendments require the lead auditor to gain an understanding of each other auditor's knowledge of the SEC and PCAOB independence and ethics requirements and their experience in applying the requirements. Are there any additional costs or practical challenges associated with this? If so, what are they, and how could the proposed requirements be revised to mitigate these issues?"

Response:

We believe the proposed amendments surrounding gaining an understanding of the other auditor(s) knowledge of the SEC and PCAOB independence and ethics requirements, and their experience in applying the requirements are prudent. There could be scenarios when additional costs and challenges are incurred, particularly if the other auditor(s) do not meet appropriate independence and ethics requirements. Or, there could be situations in which there are no viable other auditor(s) located in or near the city of the entity being covered by the other auditor, thereby requiring the lead auditor to perform the audit.

Question 28:

Should the requirement for the lead auditor to gain an understanding of the knowledge, skill, and ability of the other auditors be limited to engagement team members who assist the lead auditor with planning and supervision?

Response:

It seems appropriate to limit this understanding to team members who assist the lead auditor with planning and supervision, however the lead auditor should also obtain a clear understanding of the level of involvement, review and quality assurance practices of these other auditors and applicable team members. The lead auditor should take measures to ensure the vetted individuals are performing an appropriate supervisory role.

However, we also note that some out-of-network other auditors might be reluctant to provide the lead audit firm with details regarding local independence, ethics, or training.

Question 29:

Are the proposed requirements to determine that the lead auditor is able to communicate with the other auditors and gain access to their work papers appropriate and clear? If not, what changes to the proposed requirements are necessary?

Response:

The proposed requirement to determine that the lead auditor can communicate with the other auditors is clear. We recommend some additional explanatory material to clarify whether the communication needs to be written, oral, or if email communications can suffice. Due to language and time zone differences, email is a widely used communication tool and in certain situations it can appropriately serve as the correct means for a two-way dialogue. We recommend that the standard or release notes acknowledge that email communications can be acceptable.



Question 30:

Are the proposed amendments to the requirements for determining the locations and business units at which audit procedures should be performed clear and appropriate?

Response:

The language in AS 2101.14 is clear, and we agree that it allows for the lead auditor to hold discussions and obtain information “as necessary” because each situation and entity is uniquely different and will require auditor judgment to determine the correct level of information necessary. We recommend that language requiring that “the lead auditor should hold discussions with...the other auditors” be changed to “communicate” to align with practice and the other language where the audit team is required to determine that they can communicate with the other auditor instead of “discuss.”

Question 31:

Are the proposed procedures to be performed by the lead auditor with respect to the supervision of the other auditor's work appropriate and clear? If not, how should the proposed requirements be revised?

Response:

The procedures are clear, but we recommend that the requirement at AS 1201.b2b be modified to allow the lead auditor and the other auditor more flexibility in the development and review of the nature, timing and extent of audit procedures to be performed. Both parties will need information from the other in order to execute the appropriate response for the risks present, which requires a more collaborative, less linear flow of information in the audit engagement. The lead auditor may not know of the correct procedure set for the other auditor to perform until after the other auditor has already begun work based on information learned in other portions of the audit.

Question 32:

Currently, AS 1205.12 describes certain procedures that the lead auditor should consider performing when using the work of the other auditor (e.g., visiting the other auditor), which are not included in the proposal. Should the lead auditor be required to perform these or any other procedures? If so, what additional procedures should be required?

Response:

We believe there is some value in the lead auditor visiting the other auditor, but it should not be a requirement. The lead auditor, based on his/her judgment, should consider risk of material misstatement at business units audited by the other auditor to determine whether a visit is necessary.

Question 33:

Are the requirements for the written report from the other auditor sufficiently clear? Are these requirements appropriately scalable to the nature and significance of the work referred to the other auditor? Would the proposed requirement for the lead auditor to obtain a written report from the other auditor result in a significant change in practice? If so, what is the estimated economic impact (e.g., costs and benefits) of this change?



Response:

The requirement to obtain a written report, as drafted in the proposal, is not clear. Currently, in practice, there is no consistency as to what the content of the report should include. We believe, it would be helpful if the Board could provide some guidance as to what exactly this “report” is to say. For example, should the report include an opinion paragraph? We believe providing auditors with guidance will promote consistency in practice.

Question 34:

Is the scalability of the proposed supervision amendments clear and appropriate? If not, what changes are necessary? Are the proposed requirements for situations in which the lead auditor directs another auditor to perform supervisory procedures with respect to a second other auditor on behalf of the lead auditor clear? If not, how should the proposed requirements be revised?

Response:

We think allowing the lead auditor the flexibility to choose the correct supervision scenario is the most effective for an audit. The other auditor may have a better understanding and knowledge of the items the secondary other auditor is performing work over, in which case the lead auditor is not best suited to be the only reviewer. We think allowing for as much flexibility as possible will yield the greatest effectiveness in these situations.

Question 41:

The proposed requirement in AS 1215.19A is designed to provide additional information about the review of working papers performed by the lead auditor. Is the proposed requirement appropriate and clear? Why or why not? What other information about the review of the working papers performed by the lead auditor would be appropriate?

Response:

The proposed requirement for documentation is clear and appropriate. Documenting the review of other auditor work papers provides sufficient evidence of the supervision exercised by the lead auditor over other auditors. The evidence of what was reviewed, the person who reviewed the work paper and when it was reviewed is reasonable. The proposed standard indicates a description of the work papers that should be included. We would assume this description would be a brief notation as to the essence of the work paper and not a summary of the work paper. If the Board expects the description to be detailed or lengthy, we would request that this guidance be explicitly included within the standard.

Question 42:

The proposal does not require that the lead auditor make a list of all documents in the other auditor's files, including those not reviewed by the lead auditor. Should the lead auditor be required to document work papers in the other auditor's files that the lead auditor has not reviewed? Would such a requirement improve audit quality? What potential costs or unintended consequences, if any, would be associated with such a requirement? What practical difficulties would there be in complying with such a requirement?



Response:

We do not feel that audit quality would be improved nor would the benefit be significant for the lead auditor to document every work paper in the other auditor's file. The requirement in AS 1215.9A is sufficient in which it requires the lead auditor to document each work paper reviewed. However, the other auditor may have statutory audit work papers, tax work papers or other items in the audit file that are neither pertinent nor helpful to the lead auditor. We feel the cost of documenting every work paper would exceed any marginal benefit. The other auditors may have hundreds or thousands of work papers that may be performed for statutory reasons or stand-alone audit purposes that may not be material or relevant to the lead auditor. Due to these reasons, we do not believe a complete inventory of work papers included in other auditors' files need to be evidenced in the lead auditor work papers.

Question 43:

In addition to the information currently in AS 1215.19, should the office issuing the auditor's report be required to obtain, review, and retain other important information supporting the other auditor's work, e.g., (1) information about related parties or relationships or transactions with related parties previously undisclosed to the auditor or determined to be a significant risk; or (2) information about 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?

Response:

If another auditor performs audit procedures and documents significant transactions that are outside of the normal course of business or are unusual, we believe that this information should be sufficiently documented in the lead auditor's work papers. We believe that the lead auditor should either retain the information from the other auditor or complete its own documentation related to the significant transaction. We do not believe that it is necessary for the lead auditor to retain information related to related parties or relationships that are not previously disclosed. First of all, this does not provide a level of significance such as significant or material related party transactions. Second, we feel that it is appropriate for this information to be documented within the lead auditor or other auditor work papers, but it is not necessary to be in both locations.

Question 44:

In addition to the information currently in AS 1215.19g about all significant deficiencies and material weaknesses in internal control over financial reporting, should the office issuing the auditor's report be required to obtain, review, and retain information about all control deficiencies identified by other offices of the firm and other auditors?

Response:

As required by AS 2201 paragraph 62 "The auditor must evaluate the severity of each control deficiency that comes to his or her attention to determine whether the deficiencies, individually or in combination, are material weaknesses." Based on this requirement, we believe that all deficiencies should be communicated to the lead auditor. The lead auditor would not be able to evaluate all deficiencies to determine if the combination would lead to a material weakness if these deficiencies were not communicated. Therefore, we feel that the other auditor should provide documentation of all deficiencies to the lead auditor.



Question 46:

Are there any additional engagement quality review procedures that should be required for audits that involve "other auditors" or "referred-to auditors" (as proposed to be defined)?

Response:

We do not believe that any additional review procedures should be required for the engagement quality reviewer.

Question #47:

Are the objectives of the proposed new standard clear and appropriate? If not, what changes are necessary?

Response:

We suggest broadening the objectives. The proposed objectives are focused on two elements of this process: 1) Consolidation or combination of accounts and 2) Preparation of the lead auditor's report. We feel the objectives should also cover the assessment of the referred-to-auditor's independence and competence and proper communication between the lead auditor and referred-to-auditor to clarify roles and responsibilities.

The requirements and the introduction appear reasonable. Therefore, this response suggests improved alignment between the objectives with the rest of the proposed standard.

Question #48:

Are the proposed requirements for performing procedures with respect to the audit of the referred-to auditor clear and appropriate? If not, what changes are necessary?

Response:

The proposed requirements appear clear and appropriate.

Question #49:

Are the conditions included in paragraph .06 of the proposed new standard clear and appropriate? Are there other conditions that should be met for the lead auditor to divide responsibility with a referred-to auditor?

Response:

The conditions in paragraph .06 are clear and appropriate.

Question #50:

Paragraph .07 of the proposed new standard describes the lead auditor's course of action in situations in which the lead auditor cannot divide responsibility. Are the requirements in this paragraph clear and appropriate? Why or why not? Are additional requirements necessary for such situations?



Response:

The proposed requirements appear clear and appropriate.

Question #51:

An unintended consequence of the Board's proposal, described earlier in this release, is the potential increase in the use of the divided responsibility model by auditors. Should the Board prohibit divided responsibility arrangements or impose further limitations on them, such as limiting them to equity method investees or situations in which the referred-to auditor covers only a small portion of the consolidated assets or operations? If so, what would be the costs and benefits of such a prohibition or limitation?

Response:

It would be helpful for the Board to include its insight into appropriate circumstances for the proposed new standard's use. Such language was included in AS 1205 for engagements with divided responsibility. Limitation of its use is otherwise not deemed necessary.

While we understand the Board's concern that the lead auditor may prefer to divide responsibility with another firm rather than coordinate with and supervise overseas teams, we feel there are inherent practicalities which will already limit this model's use.

We believe firms are more likely to use affiliated firms within their global accounting firm networks to perform 'other auditor' work. GNFs and NAFs spend significant time and resources on common branding. Such "one firm" marketing is seen as an asset within the marketplace. Dividing responsibility between firms in the same network may adversely impact branding.

We acknowledge not all firms are party to such networks and may utilize unaffiliated firms in the performance of audits. However, as the Board noted within its release, U.S. and non-U.S. GNFs audited 56% of public companies trading on U.S. exchanges, which accounted for over 99 percent of global market capitalization. Therefore, we feel this viewpoint is representative of the majority of the profession.

Additionally, it's preferential to companies to engage one network with closely branded firms and one overarching system of quality control. As compared to engaging multiple unaffiliated firms, this arrangement eliminates redundancies in the audit process, thereby eliminating time demands of the companies' personnel by its auditors.

Lastly, lead auditors will be reluctant to appear unable to coordinate with other firms. Effective coordination and collaboration is seen as a value added component by companies given the delays and communication issues which can be common in such arrangements. Dividing responsibility may be seen as an inability to collaborate with other firms.

In summary, we feel the demands and expectations of companies will outweigh the lead auditors' desire to increase its use of the divided responsibility model.

Question 52:

Are additional requirements, including supervisory requirements, necessary to describe responsibilities of the lead auditor in situation in which the lead auditor divides responsibility for the audit with another accounting firm? Are there any other situations that would present challenges with the application of the proposed requirements?



Response:

We do not believe any supervisory requirements should be added to the proposed standard for the lead auditor related to the situation when the lead auditor divides responsibility for the audit with another accounting firm. This situation relates to when responsibility for the audit is divided. If the lead auditor has supervisory requirements, it would complicate the situation and potentially confuse the public since supervisory responsibilities would go beyond a division of responsibility. If the lead auditor supervised the other auditor that has responsibility for a portion of the audit, it could lead someone to determine that the lead auditor did not divide responsibility and may have responsibility over the entire audit. This is contrary to the division of responsibility included in the standard.

Question 53:

Is superseding AI 10 appropriate, or is the interpretation necessary to fully describe the auditor's responsibilities under PCAOB standards?

Response:

We believe that superseding AI 10 is appropriate and that the concepts in AI 10 are included in the proposed standard.

Question #54:

Are the other proposed amendments relating to inquiries about professional reputation and standing of other auditors appropriate and clear in the context of each requirement? If not, what further amendments should the Board consider making to this requirement to improve its clarity?

Response:

We recommend that the Board clarify its expectations of lead auditors when other auditors are deemed to have insufficient experience and knowledge. Is increased oversight sufficient, or does the Board expect the lead auditor to engage a different firm with a higher level of relevant experience and knowledge? Or should the lead auditor provide the necessary resources to complete the audit.

Question 57:

Paragraph .10d of AS 1301 (currently Auditing Standard No. 16), Communications with Audit Committees, describes requirements regarding the lead auditor's communication to the audit committee of certain information about the other auditors. Should the lead auditor's communication to the audit committee with respect to the lead auditor's or other auditors' responsibilities in an audit be more specific than is currently required? If so, what additional information should the lead auditor communicate?

Response:

We think what is required in 10d and e is sufficient. If you delve too deeply into specific high risk areas, etc., then you invite controversy over auditor judgments. Paragraph 10e already asks the lead auditor to state the basis for the lead partner's determination that their supervision of other firms was sufficient. We believe this information would be sufficient.



Question 58:

Because the Board's proposal focuses on audit engagements, it does not include amendments for engagements other than audits. Should the proposal include changes for reviews of interim financial information under AS 4105, Reviews of Interim Financial Information (currently AU sec. 722, Interim Financial Information) that involve "other auditors" or "referred-to auditors" (as proposed to be defined)? If so, what additional changes are needed?

Response:

Yes, this should also cover interim reviews.

Question 59:

Is it sufficiently clear when AS 1201 (as proposed to be amended) or proposed AS 1206 – as opposed to AS 2503 – would apply to an audit of a company's equity method investment or other investments in an entity whose financial statements are audited by another accounting firm? If not, what change or guidance is needed?

Response:

We think it is clear. AS 1206- page A2-1, footnote 3, states the definition of financial statements that include- "through consolidation or combination- the financial statements of the company's business units." To add clarity, you could state the referred to auditor would not include the auditor of equity method investments or other investments whose financial statements are audited by another accounting firm.

The Illinois CPA Society appreciates the opportunity to express its opinion on this matter. We would be pleased to discuss our comments in greater detail if requested.

Sincerely,

James R. Javorcic, CPA

Chair, Audit and Assurance Services Committee

Scott Cosentine

Vice Chair, Audit and Assurance Services Committee



ILLINOIS CPA SOCIETY.

APPENDIX A
**AUDIT AND ASSURANCE SERVICES COMMITTEE
 ORGANIZATION AND OPERATING PROCEDURES
 2016 – 2017**

The Audit and Assurance Services Committee of the Illinois CPA Society (Committee) is composed of the following technically qualified, experienced members. The Committee seeks representation from members within industry, education and public practice. These members have Committee service ranging from newly appointed to almost 20 years. The Committee is an appointed senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of audit and attestation standards. The Committee's comments reflect solely the views of the Committee, and do not purport to represent the views of their business affiliations.

The Committee usually operates by assigning Subcommittees of its members to study and discuss fully exposure documents proposing additions to or revisions of audit and attestation standards. The Subcommittee develops a proposed response that is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times includes a minority viewpoint. Current members of the Committee and their business affiliations are as follows:

Public Accounting Firms:**National:**

Timothy Bellazzini, CPA	Sikich LLP
Todd Briggs, CPA	RSM LLP
Scott Cosentine, CPA	Ashland Partners & Company LLP
Heidi DeVette, CPA	Johnson Lambert LLP
Eileen M. Felson, CPA	PricewaterhouseCoopers LLP
Michael R. Hartley, CPA	Crowe Horwath LLP
James R. Javorcic, CPA	Mayer Hoffman McCann P.C.
Timothy Jipping, CPA	Plante & Moran PLLC
John Offenbacher, CPA	Ernst & Young LLP
Elizabeth J. Sloan, CPA	Grant Thornton LLP
Richard D. Spiegel, CPA	Wipfli LLP
Kevin V. Wydra, CPA	Crowe Horwath LLP

Regional:

Jennifer E. Deloy, CPA	Marcum LLP
Barbara F. Dennison, CPA	Selden Fox, Ltd.
Genevra D. Knight, CPA	Porte Brown LLC
Andrea L. Krueger, CPA	CDH, P.C.

Local:

Matthew D. Cekander, CPA	Doehring, Winders & Co. LLP
Lorena C. Johnson, CPA	CJBS LLC
Mary Laidman, CPA	DiGiovine, Hnilo, Jordan & Johnson, Ltd.
Carmen F. Mugnolo, CPA	Trimarco Radencich, LLC
Jodi Seelye, CPA	Mueller & Company LLP
Joseph Skibinski, CPA	

Industry:

Matthew King, CPA	Baxter International Inc.
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Educators:

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Northern Illinois University

Staff Representative:

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Illinois CPA Society



18 July 2016

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PCAOB Release No. 2016-002, PCAOB Rulemaking Docket Matter No. 042

**Proposed Amendments Relating to the Supervision of Audits Involving
 Other Auditors
 And Proposed Auditing Standard –
 Dividing Responsibility for the Audit with another Accounting Firm**

Dear Sirs,

The IDW appreciates the opportunity to comment on the above mentioned Release, hereinafter referred to as “the Release”.

In this letter we include comments of a general nature before highlighting our concerns in respect of specific issues or specific aspects of the proposals. Since divided responsibility is not prevalent in Germany, we have chosen not to comment on the aspects of the Release relating to division of responsibility. Furthermore, we have not responded specifically to the 59 questions posed throughout the Release. However, certain of our comments may be directly relevant to one or more of these questions.

General matters

Support for aligning PCAOB standards with recent developments

In general, we support the PCAOB’s initiative to improve audit quality by revisiting its now somewhat outdated interim standards dealing with the use of the work of other auditors. We specifically support using a risk-based approach

GESCHÄFTSFÜHRENDER VORSTAND:
 Prof. Dr. Klaus-Peter Naumann,
 WP StB, Sprecher des Vorstands;
 Dr. Klaus-Peter Feld, WP StB;
 Dr. Daniela Kelm, RA LL.M.



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that will align the PCAOB's standards more closely to recent improvements in the IAASB's standards (i.e., revision of ISA 600 during the IAASB's so-called Clarity Project) and the IAASB's ongoing consideration of this aspect of the audit as evidenced in its recently issued Invitation to Comment (ITC). Certain of our member firms have reported changes in auditing practice beyond this, which also mirror the Release's discussion of evolving practices.

This notwithstanding, we believe that the proposals would result in lead auditors having to adapt a highly bureaucratic approach to the supervision of other auditors, which, whilst it may make it easier for the PCAOB to fulfil its inspection responsibilities, will not necessarily result in improved audit quality. To the extent that in complex group situations the proposals lean towards having the lead auditor increasingly bypass other auditors who may be lead auditor at subgroup levels, the proposals seem to overly simplify situations or circumstances that are not simple in practice.

Coordination with the IAASB in the light of the recently issued ITC

As the PCAOB is aware, amongst other things the IAASB's ITC sought interested parties' views as to practicalities regarding group audits and the use of work performed by other auditors.

Aspects of the IAASB's current discussions including its analysis of responses received to this ITC will clearly be equally relevant to the PCAOB's standard setting beyond the current proposed amendments. Such aspects include diverse issues such as the increasing use of shared service centers, qualitative factors impacting the determination of the involvement of the lead auditor or approach to determining materiality, especially where a group is made up of a large volume of individually insignificant companies. Application of the concept of materiality in a group audit is another issue that is per se not specifically addressed within the PCAOB's proposals.

We encourage the PCAOB to liaise closely with the IAASB going forward in understanding the issues raised in the latter's deliberation of input to its ITC in order to monitor the potential impact on the PCAOB's suite of auditing standards.

Support for global consistency using a principles-based approach

The IDW continues to be a firm supporter of principles- rather than rules-based auditing standards. We therefore note the discussions within the Release asking



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for views as to whether certain aspects of the proposals might be strengthened, resulting in the inclusion of further rules-based requirements. In particular, the IDW does not believe the PCAOB should require that the EQC-reviewer evaluate 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 (q. 45). The need for such evaluation should be based on the individual engagement circumstances, taking account of the related risks. We have similar views in respect of whether the lead auditor should specifically identify and document the engagement team members responsible for assisting the engagement partner of the lead auditor in fulfilling his or her supervisory responsibilities (q.19), whether quantitative thresholds or other criteria should be prescribed for determining whether a firm's participation is sufficient (q.21), issues pertaining to access to working papers (q.29), and required procedures in considering the work of the other auditor (q.32) amongst others.

Specific issues

Proposal to withdraw AS 1205 and insert material into existing standards

Complex group structures stretching across numerous different countries pose special challenges to lead auditors not encountered in audits of simple groups and single entities, e.g., differing financial reporting frameworks that need to be aligned, cultural differences, and access restrictions. Materiality in a group audit context is a further such issue. The practical application of acceptance, direction and supervision responsibilities will necessarily differ in practice in comparison to situations where the engagement team members all work directly within the firm issuing the audit report and no other auditors are involved. This may be especially pronounced where a company's management and the other auditor are physically located in another jurisdiction from that of the lead auditor's firm.

We believe that revision of AS 1205, aligning it to ISA 600 and incorporating adaptations to reflect developing audit practice, might be more appropriate than the proposed piecemeal changes to numerous existing standards, which give rise to copious cross references both within and between standards. The proposals add an (avoidable) challenge to most audit firms currently used to applying AS 1205 as well as firms familiar with ISA 600. The proposed addition of the term "other auditor" within the definition of "engagement team" means that certain requirements become less obvious or even unclear. In our view, the



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PCAOB has not made a sufficient case for proposing this course of action as opposed to the retention of a revised version of AS 1205.

Need for a similar construct to “component” adopted by the IAASB

Whilst the PCAOB is not proposing to use the IAASB's concept of component and component auditor, it does still appear to us that a similar construct is needed, in particular for situations in which the operations of SEC registrants are highly decentralized. For example, in regard to the determination of the sufficiency of a firm's participation to serve as lead auditor (page A4-14 et seq. and proposed paragraph B2 of AS 2101) the term “portion of the financial statements” is used. We further note that changes proposed to AS 2401 *Consideration of Fraud in a Financial statement Audit* involve the replacement of the term “component” with “business unit”. The Release uses “locations and business units” on occasion. Inconsistent use of terminology is not desirable.

Sufficient participation of the lead auditor's firm

We note that the IAASB does not use the notion of meaningful portions of financial statements: instead phrasing its participation requirement for the group auditor in terms of the group engagement partner being satisfied as to the group engagement team's ability to be involved in the work of component auditors to the extent necessary to obtain sufficient audit evidence of the consolidation process and the financial information of the components on which to base the group audit opinion. Such evidence is obtained by various means: direct performance of the audit procedures; appropriate extent of involvement in the work of the other auditor etc., supported by direction and supervision.

Our concern is that the standards may be insufficiently clear as to the need for the lead auditor to become more directly involved in certain aspects of the audit work. Phraseology that delineates “portions of financial statements” does not capture this concept at all, and may lead to misunderstandings in the context of sufficiency of participation.

Lead auditor's consideration of other auditors

According to proposed paragraph B6 of AS 2101, the lead auditor is to gain an understanding of other auditors' knowledge, skill, and ability. As proposed, this applies in respect of other auditors “who assist the lead auditor with planning or supervision”. Q. 28 specifically asks whether B6 is appropriate as proposed.



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Whilst we support not widening the proposed requirement to cover each and every individual who would be covered by the revised definition of engagement team, we believe a principles-based approach would be more appropriate. Specialists in particular, but also other members of the engagement team, may be involved in the performance of audit procedures which, whilst they do not equate with assisting the lead auditor's engagement partner in fulfilling planning and supervisory responsibilities, nevertheless could be judged by the lead auditor to be of a certain significance in the particular engagement circumstances. We suggest that the lead auditor's understanding, as required in paragraph B6 of AS 2101, should not be limited to certain individuals. A principles based approach to B6 would involve the lead auditor exercising professional judgment in obtaining the understanding sufficient for his or her purposes in the individual engagement circumstances. Furthermore, consideration should also be given to the structure of lines of accountability and reporting in the firms of other auditors. The members of the engagement team within another firm often report to a partner, who then reports to the engagement team in the firm of the leading auditor. In this case, the lead auditor's understanding should relate to the partner of the other auditor that reports to the lead auditor because, provided this partner is competent, he or she will ensure that the members of the engagement team within the firm of the other auditor will be appropriately competent and independent.

We note that the list in Appendix B of AS 2101 does not specifically include reference to factors affecting the ability of the lead auditor to use the work of another auditor, such as common quality control policies and procedures, and whether the other auditor is subject to robust professional oversight, etc. Such factors are also relevant to the determination of the extent of the lead auditor's own involvement in the work of the other auditor (refer to ISA 600.A33 and 600.A40) or the assignment of team members pursuant to AS 2301.05.

Impact of effective communication and associated documentation requirements on audit quality

We support the proposed requirements governing the lead auditor's communication with other auditors in Appendix B of AS 1202 *Supervision of the Audit Engagement*. Communication between the group auditor and component auditors is one of many issues discussed by the IAASB in its ITC. It is clear that deficiencies in the two-way communication between the lead auditor and other auditors can have an adverse impact on audit quality.



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However, we are concerned that the overly-prescriptive requirements concerning the report to be prepared by the other auditor proposed in AS 1201 Appendix B2b and B2d (written report describing the other auditor's procedures, findings, conclusions and, if applicable, opinion) may not be appropriate in all circumstances, particularly when the lead auditor will have full access to audit documentation prepared by the other auditor. Besides being costly, duplication of matters at the level of detail proposed will not, of its own, lead to an improvement in audit quality, and may even be counterproductive if it diverts resources from the primary audit work. We are not convinced that the arguments put forward in the Release as to the potential for this aspect of the proposals to increase other auditor accountability will justify the costs in all cases. The IDW believes – emerging practice in many firms notwithstanding – that there needs to be sufficient flexibility to address a multitude of situations including taking into account the relative risk of material misstatement and circumstances where access to working papers is straightforward as well as where this is expected to be problematical.

Page A4-42 of the Release explains that in some circumstances (in particular, issues relating to restricted access/transfer of documentation) lists of other auditor's working papers reviewed by a senior team member of the lead auditor would allow the engagement partner in the office issuing the auditor's report (or other internal and external reviewers) to determine the extent of that senior team member's review of documents located in the other auditor's office. The desire to have such a list of documentation drawn up – which is in addition to the detailed reports on the audit mentioned in the preceding paragraph – seems not to be essential to increasing audit quality. When the engagement partner in the office issuing the auditor's report elects to delegate the review of work performed by other auditors to a senior team member of his or her own office, we see little benefit within that office in terms of increased audit quality of having a list drawn up as proposed.

We therefore agree with the position explained in the Release that requiring the lead auditor to compile a list of all audit documentation i.e., that reviewed and that not reviewed in a different country from that of the lead auditor would not be necessary for audit quality and would therefore be unnecessarily burdensome.

Delegation of supervision responsibilities

The Release explains how a risk based approach should be taken in determining whether the lead auditor may delegate certain supervision responsibilities in a multi-tiered group structure. The proposed additions to



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AS 1202 are unclear as to the risk based application of the 6th sentence of B3 of AS 1201 (the lead auditor, in supervising the first other auditor, should evaluate the first other auditor's supervision of the second other auditor's work) when read in conjunction with footnote 24 (the requirements of this paragraph also apply to audits in which there are multiple second other audits). Firstly, in a complex group structure with numerous layers, should each other auditor acting as "reviewer" act in the same way down the chain? If so, this would result in the lead auditor reading a report on the review of a review of a review...etc. potentially far removed from the actual audit procedures performed. This would appear to us to be likely excessive for a low risk area, and possibly mean that the lead auditor were too far removed from the audit procedures in the case of an area of higher risk. It would be preferable to keep in mind the lead auditor's objective and use a more flexible and risk-based approach; otherwise following this requirement to the letter could become absurd in practice, detracting from the lead auditor's need to be satisfied that sufficient audit evidence has been obtained to enable him or her to form an opinion.

Statement concerning potential increases in costs

We take issue with the statement on page 40 of the Release immediately preceding question 7: "To the extent that auditors incur higher costs to implement proposed requirements and are able to pass on at least part of the increased costs through an increase in audit fees, companies could incur an indirect cost." This statement implies in the public domain that the PCAOB may take a somewhat complacent view, considering it reasonable for audit firms alone to bear part or all of any additional costs resulting from revisions to its auditing standards, which may also have other audit quality implications. We suggest that consideration of the cost: benefit in terms of increased audit quality for the market as a whole would be more appropriate.

If you have any questions relating to our comments in this letter, we should be pleased to discuss matters further with you.

Yours truly,

Klaus-Peter Feld
Executive Director

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July 29, 2016
Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

PCAOB Rulemaking Docket Matter No. 042: *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Accounting Firm*

Dear Ms. Secretary:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or the Board) Release No. 2016-002, *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Accounting Firm* (referred to as the proposed amendments and the proposed standard, respectively, and collectively as the Proposal).

The Board has requested public comment on the Proposal that is intended to improve audit quality and investor protection through enhancements to the current requirements related to the lead auditor's responsibilities concerning 1) the supervision of other auditors and 2) referred-to auditors. Overall, we support the Board's initiative to further strengthen audit quality and investor protection with respect to audits that involve other auditors and referred-to auditors.

Overview

KPMG agrees with the PCAOB's intended goal to provide a more uniform, risk-based approach to supervision in audits that involve other auditors. We agree that superseding Auditing Standard (AS) 1205, *Part of the Audit Performed by Other Independent Auditors*, and amending AS 2101, *Audit Planning*, and AS 1201, *Supervision of the Audit Engagement*, which requires a level of supervision by the lead auditor of other auditors commensurate with the associated risks, is useful in harmonizing the standards. In current practice, many of the larger audit firms, such as KPMG, have implemented changes to their methodology to expand lead auditor responsibilities to address risks associated with relying on the work of other auditors, which is consistent with the approach taken by the PCAOB.

Consistent with the Board's views, we believe that when parts of the audit are performed by other auditors, encompassing those responsibilities and requirements under AS 1201 will further enhance audit quality and strengthen investor protection. However, we believe the Proposal risks falling short of the PCAOB's goals by not consistently applying the concept of a risk-based approach. In our view, the Proposal goes too far in requiring specific procedures to be performed by the lead auditor, regardless of risk. In addition to our concerns over the nature and extent of the prescriptive requirements, we also suggest the Board clarify certain aspects included in the proposed amendments and proposed standard.

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Below we have expanded on our observations on the Proposal that we deem to be key and require further consideration by the Board.

Reliance on a Firm's Quality Control System

We do not believe the proposed amendments and proposed standard sufficiently consider an audit firm's system of quality control and the benefits that accrete to the engagement when the system of quality control is effective. To illustrate this, we point to the PCAOB Quality Control Section 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice* (QC 20), which requires firms to establish a system of quality control that ensures "its personnel comply with the professional standards applicable to its accounting and auditing practice."¹ The system of quality control is defined as "a process to provide the firm with reasonable assurance that its personnel comply with applicable professional standards and the firm's standards of quality."² Required elements of a system of quality control include: 1) independence, integrity, and objectivity; 2) personnel management; 3) acceptance and continuance of clients and engagements; 4) engagement performance; and 5) monitoring. QC 20 continues by stating "[t]he system of quality control should provide the firm with reasonable assurance that the segments of the firm's engagements performed by its foreign offices or by its domestic or foreign affiliates or correspondents are performed in accordance with professional standards in the United States when such standards are applicable."³

Therefore, to comply with QC 20, audit firms have established a quality control system that is used when assigning audit engagement responsibilities to the lead audit partner, engagement managers and engagement quality reviewer (EQR), among others, to conduct those audits, and these systems support the quality of work performed by the engagement team and EQR. As such, a risk-based supervisory approach should take into consideration a firm's evaluation of the system of quality control. To perform this assessment, the lead auditor would evaluate information that is made available to them (e.g., internal/external reports on a firm's and/or individual's inspection results, information on compliance with training or other requirements, etc.) as well as make inquiries of the other auditors regarding the existence of any exceptions to the quality controls on which the lead auditor is relying (e.g., Have the individuals on the engagement team been subject to quality performance reviews as scheduled?, What were the results of the individual's latest performance evaluation?, etc.). Based on this evaluation of the firm's system of quality control, in conjunction with the lead auditor's consideration of the risks presented by the operations of the foreign location and evaluation of the professional competency of the other auditor (partner and manager), the lead auditor would determine the extent of supervision required of the other auditor. For example, if Firm A is determined to be the lead auditor and Firm B, a network firm, reports to Firm A, Firm A should determine the level of supervision required based on its assessment of the knowledge, skill, and ability of Firm B's engagement partner (and EQR as applicable) and engagement managers, which might be

¹ PCAOB Quality Control Section 20, paragraph .03

² Ibid

³ PCAOB Quality Control Section 20, paragraph .06

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accomplished through Firm A's assessment of Firm B's system of quality control. Based on that assessment, Firm A is able to determine the extent of supervision that is required of Firm B's engagement partner (and EQR as applicable) and engagement managers responsible for the local audit.

While lead auditors would retain responsibility for the quality of their audit engagements, recognizing and enabling them to rely on the system of quality control allows them to fulfill their responsibilities more effectively and efficiently, and would not diminish audit quality. We encourage the Board to consider revising the Proposal to include this element as well as recommend that the Board provide implementation guidance or illustrative examples of when and under what circumstances it would be appropriate to place such reliance, as well as the level of documentation that would be expected to demonstrate the appropriateness of such reliance.

To demonstrate the benefits achieved by incorporating such reliance on the system of quality control into the proposed amendments, the lead auditor would be able to apply professional judgment when determining the nature and extent of supervision, and specifically which working papers are necessary for him/her to review. This would eliminate duplicated efforts of review (i.e., unnecessary review of a working paper by both the lead auditor and other auditor) when it has been concluded that the other auditor may be more appropriately positioned to review certain working papers due to their knowledge and experience at the local company or business unit and the risk associated with that audit area.

Lastly, if the system of quality control is not considered, the result may include a significant increase in audit costs with uncertain meaningful additional direct or indirect benefit to audit quality or investor protection. Based on the above observations, we recommend the Board harmonize the Proposal with its quality control standards and allow lead auditors to assess and place reliance on these systems of quality control, when appropriate.

Determination of the Lead Auditor, Including Concluding on Sufficient Participation

Additional guidance is needed to clarify the factors an auditor should consider when determining whether its own participation is sufficient to enable it to issue the auditor's report on the company's financial statements and therefore serve as the "lead auditor." Otherwise, various interpretations of the Proposal could occur, which could lead to diversity in practice. For example, the Proposal is not clear if the determination is based on plurality of risk or majority of risk. Based on the examples on pages A4-15 – 18 of the Proposal, it appears to be based on plurality of risk, and we believe it would be beneficial to explicitly indicate such in the final amendments, if that is the PCAOB's intent. In addition, paragraph B2 of AS 2101 indicates that the determination of sufficiency "should take into account 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 ..." We believe clarification of the phrase "performs audit procedures" is needed, because we can envision various scenarios where it would be appropriate to consider one firm to be the lead auditor, even though most, if not all, of the back office accounting function may be located in a different country and audited by a different firm.

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Direct and active supervision and oversight of one firm's engagement team by another firm should be a factor, we believe, in assessing sufficiency of participation, but we do not know whether those supervision and oversight activities are contemplated by the PCAOB to be included within the "performs audit procedures" phrase.

Furthermore, the proposed amendments require the EQR to evaluate the lead 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."⁴ Under the current standard (specifically, AS 1220, *Engagement Quality Review*), the EQR "should evaluate the significant judgments made by the engagement team...", which would include evaluating whether his/her firm should act as lead auditor if significant judgment was required to be exercised. Determining the ability to act as the lead auditor does not always require significant judgment. Therefore, we do not believe this proposed amendment is necessary, and we recommend the PCAOB not change the current requirements of AS 1220.

Specific Performance Requirements for the Lead Auditor

Although KPMG agrees with the PCAOB that the lead auditor should perform procedures to evaluate the knowledge, skills, and ability of other auditors, more specific guidance is requested to understand the nature and extent of this assessment. For example, it is unclear if inquiry of the other auditor is sufficient to gain an understanding of the other auditor's skills and experience. Further, as it relates to other auditors from out-of-network firms, it may be challenging to obtain evidence of skills and experience beyond inquiry. As such, we suggest that the proposed amendments limit the required procedures regarding the assessment of the knowledge, skills, and ability of the other auditors to inquiry. If more robust procedures are intended by the Board, we believe that the Board should be more specific as to the nature and extent of such procedures. In addition, we believe the PCAOB should clarify that it would be appropriate for these procedures to be performed at the engagement team level, rather than at an individual team member level. Under this approach, the other auditor's engagement partner could confirm to the lead auditor on behalf of his/her firm and engagement team members, which is consistent with current practice.

In addition, as noted by the Board as a possible unintended consequence of the proposed amendments, requiring the lead auditor to perform additional supervisory responsibilities could result in the lead auditor inefficiently allocating audit resources and incorrectly focusing his/her attention on an area of the audit with less risk⁵, which could result in a material misstatement remaining undetected in a higher risk area. Although this may be mitigated through the application of a risk-based approach, the relatively prescriptive requirements of the Proposal undercuts an auditor's ability to make risk-based assessments. Instead, if the lead auditor was permitted to consider the system of quality control, as discussed above, and then determine the extent of supervision required based on risk (including the risk presented by the other auditor's

⁴ Page A1-25 of the Proposal.

⁵ Page 41 of the Proposal.

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system of quality control, the individual auditors' competencies, and the audit work to which they are assigned), such concerns regarding the lead auditor incorrectly focusing on lower risk areas would be reduced.

Furthermore, it is usually necessary to complete the procedures over work performed by other auditors closer to the end of the audit so that the other auditors have a sufficient amount of time to effectively perform their required procedures. This imposes constraints on the lead auditor in terms of audit resource allocation and its ability to perform an effective review/supervision of the other auditor's work when up against a filing deadline, while also performing other completion requirements in advance of the filing deadline, such as communications with those charged with governance, assessment of uncorrected misstatements or internal control deficiencies, and drafting of critical audit matters.⁶ In such circumstances, audit quality could be hindered, which would jeopardize the overall goal of the PCAOB to enhance audit quality and improve investor protection.

Lastly, imposing prescriptive requirements related to the lead auditor's responsibilities over other auditors also goes beyond the Board's intentions to "provide additional direction" as stated on page 20 of the Proposal. "Additional direction" generally indicates a path for the auditor to take but allowing him/her to determine the specific approach or means to completing that path, which we support. Although we agree that additional direction is necessary, we propose the Board consider using implementation guidance or illustrative examples, as appropriate, to illustrate the risk-based approach, and not impose prescriptive requirements.

Therefore, based on the above comments, we encourage the Board to revisit the specific requirements related to the supervision of other auditors. If the Board does not believe consistency in application of the amendments is achievable through implementation guidance or illustrative examples, we propose the specific requirements be as limited as possible so as to not deteriorate the foundation of the Proposal as risk-based.

AS 1206

As it relates to the PCAOB's proposed standard, AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*, KPMG accepts the views of the PCAOB on dividing responsibility of the audit with another audit firm and is not opposed to the issuance of a separate standard to address this matter.

We do request clarification of the Board's expectation of the lead auditor to comply with paragraph .06c of AS 1206. As currently drafted, the lead auditor is to inquire if the referred-to auditor "knows the relevant requirements of the applicable financial reporting framework,

⁶ PCAOB Release No. 2016-003, *Proposed Auditing Standard - The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards*, proposes critical audit matters be communicated in the auditor's report. This assumes the concept of critical audit matters, in some form, is eventually made effective.

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standards of the PCAOB, and financial reporting requirements of the SEC.” However, on page A4-52 of the Proposal, it indicates that to comply with this requirement, the lead auditor could “discuss the referred-to auditor’s prior and current work experience that may be relevant to evaluating the professional competence” of the referred-to auditor. Evaluating the professional competence of the referred-to auditor appears to go beyond what is required under paragraph .06c, as currently drafted, and therefore, we recommend the Board revise the example procedures described on page A4-52. However, if it is the Board’s intention to have the lead auditor evaluate the knowledge, skills, and ability of the referred-to auditor to the extent required of other auditors in the proposed amendments, which we do not believe is necessary given the division of responsibility, we suggest the Board revise the proposed standard. We also propose the Board allow the lead auditor to rely on a firm’s system of quality control, as discussed above, when assessing a referred-to auditor in accordance with paragraph .06c of AS 1206.

Other

With the increased requirements over other auditors and referred-to auditors under the proposed amendments and proposed standard, respectively, we believe that the PCAOB should consider if a requirement and/or guidance is needed with respect to the expectation that other auditors and referred-to auditors, if such firms are registered with the PCAOB, would cooperate with the lead auditor’s efforts to comply with the requirements of the issued amendments and new standard. A risk exists whereby the lead auditor may not be able to complete the required procedures because of a lack of cooperation and therefore would be required to issue a disclaimer of opinion due to a scope limitation or withdraw from the engagement. For example, Audit Firm A audits Company X, a biotechnology company. Audit Firm B audits Company Z, which has an equity investment in Company X that is material to Company Z. There is a risk that Audit Firm A may not respond or cooperate with Audit Firm B’s requests to assess knowledge, skills, and ability or provide access to working papers for review, which would prevent Audit Firm B from being able to issue an unqualified opinion, due to the scope limitation. If cooperation is not required, disclaimer opinions or forced withdrawals could result, which would hinder the PCAOB’s goals of increased audit quality, accountability by the lead auditor, and increased information to investors.

Applicability and Effective Date

Applicability

We are not aware of any strong arguments that would indicate that emerging growth companies and broker dealers should be excluded from the Proposal. We, therefore, agree with the Board that the Proposal should apply to audits of these types of entities.

Effective date

A sufficient amount of time will be necessary to evaluate and implement any changes required to our audit methodology arising from the new guidance. In addition, we will need to develop and provide training on the final amendments and new standard to all of our audit professionals.

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Therefore, we would recommend that the effective date of the final amendments and new standard should be no earlier than two years after the SEC's approval of the final amendments and new standard.

* * * * *

We appreciate the Board's careful consideration of our comments and observations, and support the Board's efforts to increase accountability of the lead auditor and improve audit quality and investor protection. If you have any questions regarding our comments included in this letter, please do not hesitate to contact George Herrmann ((212) 909-5779 or gherrmann@kpmg.com) or Rob Chevalier ((212) 909-5067 or rchevalier@kpmg.com).

Very truly yours,



KPMG LLP

cc:

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July 29, 2016

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
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Via e-mail: comments@pcaobus.org

Re: PCAOB Release No. 2016-002, Rulemaking Docket Matter No. 042, Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Accounting Firm

Dear Office of the Secretary:

We appreciate the opportunity to share our views on the Public Company Oversight Board's (PCAOB or the Board) Release No. 2016-02, *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Accounting Firm* (the Proposal).

Moss Adams LLP is one of the 15 largest accounting and consulting firms in the United States. Our staff of more than 2,000 includes approximately 260 partners. Founded in 1913, Moss Adams LLP serves as the independent registered public accounting firm for approximately 90 issuers, including several with multinational operations.

We are supportive of the Board's objective of improving audit quality as it relates to the use of other auditors on public company audits, particularly as the business environment of many public companies becomes increasingly global. The ability of a lead auditor to utilize other audit firms is often essential to the lead auditor's ability to effectively execute complex, multi-location audits. We agree that many aspects of the Proposal will serve to enhance audit quality and consistency in the profession, however, we also believe there are elements of the Proposal that warrant further consideration by the Board. Our more detailed views on these items are as follows:

Definition of the Lead Auditor

The proposed amendments to AS 2101 Appendix A define the lead auditor as, among other criteria, the partners, principals, shareholders, or employees of the registered public accounting firm issuing the

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auditor's report (AS 2101.A4b). We are concerned that limiting the definition of the lead auditor exclusively to individuals employed by the firm issuing the auditor's report is inappropriate and may result in undue complexity. There are a variety of circumstances in which it may be most effective for the firm issuing the auditor's report to utilize individual professional staff employed by other firms by directly supervising those engagement team members (as provided under existing AS 1201). In such situations, we believe it is often most appropriate to view the individuals employed by other firms as extensions of the firm issuing the report, as there may be no substantive difference between individuals employed by other firms and individuals employed by the issuing firm.

It is our view that the employee/employer relationship of individual auditors should not necessarily be a determinative factor in the definition of the lead auditor. We recommend the Board expand the definition of the lead auditor to include engagement team members who are directly supervised by the firm issuing the audit report.

Lead Auditor Participation Sufficiency

The proposed amendments in AS 2101 Appendix B state that the engagement partner should determine whether the participation of his or her firm is sufficient for the firm to serve as lead auditor by considering the portion of the company's financial statements for which the engagement partner's firm performs procedures (AS 2101.B2). We do not believe the proposed concept of the portion of the financial statements for which the "engagement partner's firm performs procedures" is adequately defined. As noted above, there are numerous circumstances when individuals employed by other audit firms perform work under the direct supervision of the firm issuing the audit report. It is currently unclear as to whether portions of an audit performed under the direct supervision of a firm would qualify as procedures performed by that firm. It is our view that the firm issuing the audit report should be able to take credit for the portion performed by other auditors under its direct supervision in determining whether the firm is able to carry out the responsibilities of a lead auditor.

In conjunction with our above recommendation on the proposed definition of the lead auditor, we urge the Board to modify the proposed amendments to allow the engagement partner to take into account the risks of material misstatement associated with the portions of the financial statements audited under his or her direct supervision that are performed by other auditors in determining whether the engagement partner's firm can carry out the responsibilities of a lead auditor in proposed AS 2101.B2.

Other Auditors' Compliance with Independence and Ethics

The proposed amendments in AS 2101 Appendix B establish the lead auditor's responsibility for ensuring other auditors' compliance with independence and ethics requirements. The Proposal states that the lead auditor should determine "each other auditor's compliance", including a requirement to obtain written representation from "each other auditor" (AS 2101.B4). As proposed, it is unclear whether the lead auditor's responsibilities apply to each individual engagement team member (who is considered an other auditor), or to each other firm that is participating in the audit. We believe the most effective method of ensuring compliance with these requirements is to rely on the other firm's system of

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quality control (which monitors individual compliance), and obtain written representations from the other auditor's engagement partner on behalf of the other firm.

We recommend the Board clarify the intent of the proposed AS 2101.B4 requirements and suggest that the Proposal be amended to explicitly allow for the lead auditor to confirm compliance with the other auditors' firms rather than individual engagement team members.

Requirements of Other Auditors

The proposed amendments to AS 1201 Appendix B require the lead auditor to, among other things, obtain a written report from the other auditor describing their procedures, findings, conclusions, and, if applicable, opinion (AS 1201.B2d). However, the Proposal does not contain instruction on the form of this report. The Proposal is also silent to the broader requirements and responsibilities of other auditors. We are concerned that the lack of authoritative guidance on the expected conduct of other auditors will lead to disparity in practice and present significant challenges to lead auditors in performing their proposed responsibilities.

We recommend the Board specify the expected form of the other auditors' report in proposed AS 1201.B2d and provide guidance on the expected responsibilities and requirements of other auditors when performing audit procedures for a lead auditor.

We appreciate the effort and time the Board has devoted to the Proposal and hope you find our comments meaningful. Please direct any questions to Fred Frank in our Professional Practice Group at 206-302-6800.

Very truly yours,

Moss Adams LLP



National Association of State Boards of Accountancy

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July 29, 2016

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

Via e-mail: comments@pcaobus.org

Re: Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors;
PCAOB Rulemaking Docket Matter No. 042

Dear Members of the Public Company Accounting Oversight Board:

We appreciate the opportunity to offer comments on the Proposed Amendments referred to above. The National Association of State Boards of Accountancy's (NASBA) mission is to enhance the effectiveness and advance the common interests of the Boards of Accountancy that regulate all certified public accountants and their firms in the United States and its territories. In furtherance of that objective, we offer the following comments on the Proposed Amendments.

We support the Board's project to improve and clarify the standards of the PCAOB that address audits involving the use of accounting firms and individual accountants that are not part of the accounting firm that issues the audit report. We also believe it is important to incorporate the PCAOB's risk based standards into the role of the lead auditor in their supervision over other auditors.

Definitions

Under the proposed amendments (Appendix A1.A4), the "lead auditor" is defined as:

- "a. The registered public accounting firm 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 1201.23."

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Including individual team members in the definition of the “lead auditor” could create confusion and practical challenges. The PCAOB may want to consider further refinements in the definition.

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

Under the proposed amendments (Appendix A1.B2):

“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 risks of material misstatement associated with the portion of the company's financial statements for which the engagement partner's firm performs audit procedures (which includes considering the portion's materiality), in comparison with the portions for which the other auditors perform audit procedures or the portions audited by the referred-to auditors.”

The Securities and Exchange Commission’s Division of Corporate Finance’s Financial Reporting Manual (4140 Principal Auditor) uses the term “principal auditor:”

“Generally, the principal auditor is expected to have audited or assumed responsibility for reporting on at least 50% of the assets and revenues of the consolidated entity.”

We recommend that the PCAOB and SEC use consistent criteria to determine the lead auditor’s responsibility.

The change in the definition of the “lead auditor” under the proposed amendments could result in situations where the firm which currently acts as a lead auditor may no longer be determined to be the “lead auditor.” This could inadvertently result in a new lead auditor that is prohibited from performing the work because they are unlicensed in the United States (or foreign jurisdiction) or fail to meet other local regulations. NASBA cautions that any final PCAOB requirements need to take into account the state accountancy regulations that use differing statutory language and interpretations to limit the signing of auditor reports to licensed individuals working in registered accounting firms, typically with licensure in the location of the client’s home state.

Under the 6th Edition of the Uniform Accountancy Act (released in 2011), only individuals who were licensed or had practice privileges in a state could sign or authorize signing an audit report for a client having its “home office” in that state, and only through an accounting firm registered in that state. The 7th Edition of the UAA (released in 2014) removed the reference to “home

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state” and lifted the firm registration requirement under certain circumstances. Language from both versions of the UAA has been implemented in a number of states in the past five years. Both the 6th and 7th editions of the UAA require that anyone signing or authorizing a signature on a report must be licensed in at least one U.S. jurisdiction. UAA §7(c)(3) & (4) have been adopted nearly verbatim in many jurisdictions. However, several jurisdictions have retained explicit licensure requirements for any individual signing auditor reports in their jurisdictions. A few states also have in place additional competency requirements for individuals signing auditor reports.

Some state boards have previously raised concerns with the PCAOB regarding unregistered firms and/or unlicensed individuals (including foreign auditors not licensed in any U.S. jurisdictions) signing reports for clients located in their states. As a result, the PCAOB now includes language in its registration letters to all PCAOB registered firms reminding registrants about the role of state regulations.

In some audits, the engagement team may be organized in a multi-tiered structure. For example, another auditor might audit the financial information of a location or business unit that includes the financial information of a sub-location, or subunit, audited by a second or third other auditor. We believe that the lead auditor’s responsibility for the supervision of other auditors should cover the first level of other auditors, with those auditors then being responsible for overseeing the work of those answering to them. This organizational structure is intended to avert significant delays and, at the same time, not dilute the lead auditor’s responsibility for the entire audit, nor the responsibility of each of the tiered auditors.

Procedures to Be Performed by the Lead Auditor with Respect to the Supervision of the Other Auditors' Work

Currently proposed amendments do not distinguish between in-network and out-of-network other auditors. The *AICPA Professional Code of Conduct*, as referenced by most State Boards of Accountancy (§1.220.010.18), defines firms in a network. One characteristic in the determination of a network firm under the Code’s interpretation is sharing common quality control policies and procedures that are monitored by the association. Given this commonly applied definition, there should be some distinction made between the levels of supervision of in-network vs out-of-network firms.

Under the proposed amendments to AS 1215 (Audit Documentation):

“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 offices of the firm and other auditors... i. All matters to be communicated to the audit committee.”

Since the PCAOB has recently issued a proposed auditing standard on the *Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, which includes a new requirement for the information to be reported in the audit report, we suggest that

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the information requirement from other auditors align with the information required to be ultimately reported in the audit report by the lead auditor (e.g. Critical Audit Matters).

Responsibilities of Other Auditors

Under the proposed amendments, the substantial responsibility for completing the audit lies with the lead auditor. There could be circumstances where other auditors will perform audits for their local clients at the same time and, thus, will have less time and accountability for the work performed for the lead auditor located in another firm/office. Absence of the explicit incentives/requirements for other auditors in the proposed amendments could diminish the other auditor's accountability for the work the other auditor performs.

Other Auditors' Compliance with Independence and Ethics

Under the proposed amendments (Appendix A1.B4):

“In an audit that involves other auditors, the lead auditor should determine each other auditor's compliance with the SEC and PCAOB independence and ethics requirements by:

- a. Gaining an understanding of each other auditor's knowledge of the SEC and PCAOB independence and ethics requirements and their experience in applying the requirements; and
- b. Obtaining a written representation from each other auditor that it is in compliance with SEC and PCAOB independence and ethics requirements.”

Obtaining independence and ethics confirmations from each individual member of the other auditor's team could result in significant delays in completion of the audit and issuance of the audit report by the lead auditor. The same objective could be met by obtaining from the engagement partner of the other auditor a confirmation of the compliance with the independence and ethics of its engagement team.

The proposed amendments (Appendix A1.B4) state:

“In an audit that involves other auditors, the lead auditor should determine each other auditor's compliance with the SEC and PCAOB independence and ethics requirements...”

To allow for such confirmation, we suggest the term “determine” be replaced with “obtain confirmation of”

Registration Status of Other Auditors

The proposed amendments (A1.B5) state:

“In an audit that involves an other 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, the lead auditor may use an other auditor only if the other auditor is registered pursuant to the rules of the PCAOB.”

We suggest adding the specification that the lead auditor may use an other auditor against whom there are currently no PCAOB sanctions and that is in compliance with applicable state laws and regulations, including state CPA licensure requirements.

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

Under the proposed amendments (Appendix 2.06.b):

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

- b. The financial statements of the company's business unit audited by the referred-to auditor were prepared using the same financial reporting framework as the financial reporting framework used to prepare the company's financial statements.”

There appears to be an inconsistency between this proposal and SEC practice as it requires the financial statements of the company's business unit audited by the referred-to auditor should be prepared using the same financial reporting framework. The SEC's *Financial Reporting Manual* (FRM) (6820.7) currently allows for financial statements of subsidiaries to be on a different basis of GAAP than the registrant as long as the audit report is clear as to which auditor is taking responsibility for the conversion of the GAAP of the subsidiary to the GAAP of the issuer.

Proposed Amendments to AS 2110 (Identifying and Assessing Risks of Material Misstatement)

Under the proposed amendments to AS 2110 (Appendix 3.11A):

“If the auditor serves as a referred-to auditor in accordance with AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*, as part of obtaining an understanding of the company, the referred-to auditor should consider making inquiries of the lead auditor as to matters that may be significant to the referred-to auditor's own audit...”

We believe that the phrase “should consider” should be strengthened to “should make inquiries.”

Proposed Amendments to AS 2410 (Related Parties)

Under the proposed amendments to AS 2410 (Appendix A3.09):

“...the lead auditor also should inquire of the other referred-to auditor regarding the other referred-to auditor's knowledge of any related parties or relationships or transactions with related parties that were not included in the auditor's communications.”

We believe the sentence above should read

“...the lead auditor also should inquire of the other referred-to auditor regarding the other referred-to auditor's knowledge of any related parties or relationships or transactions with related parties that were not included in the lead auditor's communications.”

For consistency, we suggest that all requirements with the other referred-to auditor be included in or cross-referenced to AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*.

Example of Reporting by the Lead Auditor Indicating the Division of Responsibility When Making Reference to the Audit and Report of the Referred-To Auditor

The proposed amendments (Appendix 2.B1) include an example of reporting by the lead auditor indicating the division of responsibility when making reference to the audit and report of the referred-to auditor. Since the PCAOB has recently issued a proposed auditing standard on the *Auditor's Report on an Audit of Financial Statements when the Auditor Expresses an Unqualified Opinion*, the proposed examples of audit reports in the current proposed amendments should be either included in, or cross-referenced to, the auditing standard on the *Auditor's Report on an Audit of Financial Statements*, once the proposed amendments are finalized.

Under the proposed amendment in AS 1206.08 (c):

“The lead auditor's report should 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.”

In current practice, when there is more than one referred-to auditor, the auditor's report generally combines the disclosure about the magnitude for all referred-to auditors. It is not clear if the PCAOB's intention is to have this disclosure be made for each referred-to auditor. We recommend the PCAOB consider whether and how this may conflict with current practice. The PCAOB may want to include a report example when multiple referred-to auditors exist.

Public Company Accounting Oversight Board

July 29, 2016

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* * *

Again, we appreciate the opportunity to comment on the Exposure Draft.

Very truly yours,

A handwritten signature in cursive script that reads "Donny H Burkett".

Donald H. Burkett, CPA
NASBA Chair

A handwritten signature in cursive script that reads "Ken L. Bishop".

Ken L. Bishop
NASBA President and CEO



Office of the Secretary
 Public Company Accounting Oversight Board
 1666 K Street, NW
 Washington, DC 20006-2803

July 29, 2016

RE: PCAOB Rulemaking Docket Matter No. 042 - *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard - Dividing Responsibility for the Audit with Another Accounting Firm*

Dear Madam Secretary:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (the "PCAOB" or "Board") *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard - Dividing Responsibility for the Audit with Another Accounting Firm* (collectively, the "proposals").

We support the PCAOB's consideration of enhancements and promotion of consistency in the auditor's performance when executing its supervisory responsibilities in an audit involving other auditors. We agree the level of interaction between the lead auditor and other auditors is important to audit quality, and we support actions that lead to increased and improved communications between auditors. We also support the Board's consideration of a risk-based approach, as we agree the lead auditor's supervision of other auditors should be commensurate with the risks of material misstatement at locations audited by other auditors, as well as the competency of the other auditors. We believe many of our observations included in this letter will enhance the proposals in line with the Board's intent to develop a risk-based approach.

Overall observations

We agree enhancements to the auditing standards related to the lead auditor's supervision of other auditors may improve audit quality and believe some of the concepts in the proposals and related release text could achieve that objective. However, in order to maintain or enhance audit quality, it is important there continues to be accountability of the other auditor for its work in support of the lead auditor. We are concerned that, while placing additional supervisory responsibility on the lead auditor, the proposals seem to have less focus on the responsibility of the other auditor than is currently in AS 1205. We believe this accountability is important because even with enhanced supervision responsibility of the lead auditor, it is the other auditors who are in best position to supervise and execute on the day-to-day responsibilities of the portion of the audit on which they are reporting.

AS 1205.03 is clear "the other auditor remains responsible for the performance of his own work and for his own report." While this appears to continue to be an objective of the proposals,¹ similar language is omitted from the actual text of the proposed amendments to the auditing standards. Also, some of the proposed requirements do not seem appropriately risk-based and seem to indicate the other auditor is not responsible for the day-to-day supervision of its work.

¹ See, for example, Page 41 of the proposals, which says, "Notably, under the proposal, the other auditor would continue to remain responsible for, among other things, obtaining sufficient appropriate audit evidence to support its written report describing the other auditor's procedures, findings, conclusions, and if applicable, opinion."



We are concerned rescinding the statement describing the other auditor's responsibility from the standards, when combined with the potential level of detail of planning and supervision needed by the lead auditor as described later in this letter, may result in a lack of accountability by the other auditor. Consequently, there is the potential for the other auditor to reduce its responsibility for performing the necessary day-to-day planning and supervision. Additionally, some of the definitional changes described in the proposals seem to indicate the lead auditor would need to evaluate each individual at the other auditor in certain areas (as opposed to the firm), which may not be practical and appears to be another indication of reducing the accountability of the other auditor. The potential reduction in responsibility and accountability of the other auditor, whether actual or perceived, may adversely impact audit quality.

In addition to our overarching concerns described above, the increased supervisory responsibilities placed on the lead auditor by the proposals may reduce the time the lead auditor can devote to areas of heightened risk, which are typically addressed by the lead auditor. This may also adversely impact audit quality.

In some instances, particularly when part of the audit is conducted by an other auditor outside of the lead auditor's network, it may be difficult to perform some of the required procedures contemplated by the proposals because of the inherent restrictions with relation to other auditors' partners, employees and processes. Ultimately, this may lead to more instances of dividing responsibility, which does not appear to be a goal of the Board.

We believe the other auditors are in best position to be responsible for the day-to-day planning and supervision because they are on site. Maintaining the responsibility statement in the auditing standards, as opposed to solely in release text, would emphasize the importance of the other auditor's own supervisory responsibilities. This, together with consideration of some of our other recommendations below to focus more on a risk-based approach, has the potential to increase audit quality.

In the remainder of this letter, we build on these concerns with more specifics, discuss additional concerns, and suggest potential solutions we hope will help the Board in finalizing the standards and achieving what we believe are the Board's intended outcomes.

Supervision of other auditors

Broadly, and explained throughout this letter, the proposals appear to be unclear as to the level of detail required by the lead auditor to supervise other auditors. The proposals require the lead auditor to perform certain supervisory procedures in all cases and do not appear to allow the lead auditor to appropriately leverage the other auditor when, based on the assessed risk, the lead auditor deems such leverage is appropriate. This may result in less time for the lead auditor to focus on areas of heightened risk, which are typically addressed by the lead auditor. As a result, this may have a negative impact related to audit quality and the costs may exceed the benefits. The Board appears to acknowledge this risk in the release text when it says "because lead audit personnel would be required to perform additional supervisory responsibilities, such team members might have less time to perform other work on the same engagement. This could potentially reduce the likelihood that the auditor detects material misstatements...and could potentially lead to inefficient allocation of audit resources."²

² See page 41



We acknowledge AS 1201.B1 discusses the extent of the lead auditor's supervision of the other auditors' work is determined in accordance with AS 1201.06. We believe AS 1201.06 could be enhanced to include a lead auditor's considerations of concepts in AI 10.19 and .20, including the lead auditor's knowledge of the other auditors' quality control policies and procedures and previous experience with the other auditor. We believe these concepts will be most relevant when using other auditors within the same network of firms.

We also acknowledge AS 1201.04 allows the engagement partner to seek assistance from appropriate engagement team members in fulfilling their responsibility related to the supervision of the audit and, in the context of much of AS 1201, "appropriate engagement team members" appears to include partners and managers of the other auditors. However, proposed Appendix B of both AS 2101 and AS 1201 list specific procedures required to be performed by the lead auditor and not the other auditor; therefore, the proposed Appendices do not allow the lead auditor to leverage partners and managers at the other auditors. We explain the specifics in the following sub-sections.

Nature, timing and extent of the other auditor's procedures

AS 1201.B2b would require the lead auditor to obtain and review a description of the nature, timing and extent of audit procedures to be performed by the other auditor. It is not clear how detailed this description is meant to be and does not appear to consider a risk-based approach as the requirement seems to include all procedures performed by the other auditor. For example, when a full scope audit is requested by the lead auditor, it is not clear how much detail would be required to be reviewed by the lead auditor in order to determine whether any changes to the other auditor's procedures are necessary. In such a situation, the proposal appears to imply the lead auditor may need to obtain the entire audit program or, at a minimum, all of planning (if there is sufficient enough detail therein) to review whether the other auditor's planned nature, timing, and extent of its procedures is appropriate.

We believe any requirement for the lead auditor to review the description of the nature, timing, and extent of procedures should be based on the risk of material misstatement. In other words, for areas of heightened risk, the lead auditor should perform the procedures described by AS 1201.B2b. For areas of lower risk, the lead auditor should be able to use the other auditor's review of the description of the nature, timing, and extent of procedures, if deemed appropriate by the lead auditor. We believe this would be consistent with AS 1201.04 allowance of assistants as, in areas of lower risk, the lead auditor could use the partner and manager of the other auditor as his/her assistants in supervising the work of the other auditor. We also believe this would be consistent with the Board's intent as the release text states, "...under the proposal, the lead auditor would focus its efforts on audit areas with the greatest risk of material misstatement to the financial statements. This should result in an appropriate focus on the riskiest audit areas, whether those areas are audited by the lead auditor directly or by another auditor under the lead auditor's supervision."³ As it relates to the description of the nature, timing, and extent for heightened risk areas, we also believe the Board should consider whether the level of detail of this description does not have to be as robust when there is a common methodology, similar processes, a common system of quality controls and specific training and monitoring among network firms.

Obtaining a written report

We support maintaining the required documents to obtain, review and retain from other auditors consistent with AS 1215.19. AS 1201.B2d, though, would require the lead auditor to also obtain a written report describing the other auditor's procedures, findings, conclusions and, if applicable, opinion. Similar

³ See page 41



to our concerns on the nature, timing and extent of planning, it is not clear how detailed this description is meant to be. For example, it is not clear if the written report, separate from the opinion, would require a description of each and every procedure performed by the other auditor which, in essence, could be interpreted to require the lead auditor to review, directly or indirectly, every audit procedure that is documented in the audit file of each other auditor. While the release text is clear the lead auditor is not required to review all workpapers of the other auditor,⁴ it is possible a “written report” with such detail would essentially equate to all audit procedures documented in the workpapers.

We believe the written report obtained by the lead auditor should be limited to describing the other auditor’s procedures, findings and conclusions for areas of heightened risk. Even for areas of heightened risk, we believe there should not be a requirement to obtain each individual workpaper and each standard step (unless determined by the lead auditor to be appropriate, as discussed below) but, rather, the descriptions obtained by the lead auditor should include a summary of the procedures performed in these areas. For example, nature and precision of substantive analytics, nature of the test of detail performed, and level of audit evidence obtained. The other auditor’s opinion and other required communications would be sufficient to satisfy the requirement for the lead auditor to review the remainder of the work of the other auditor or, if an opinion is not obtained, the written report contemplated by AS 1201.B2d could be limited to findings and conclusions for areas of lower risk if deemed appropriate by the lead auditor based on the risk of material misstatement. Similar to the nature, timing, and extent of procedures in the planning phase discussed above, we believe the Board should also consider the level of detail to be provided if the firm is part of the same network of firms and that network has a common methodology, similar processes, a common system of quality controls and specific training and monitoring related to PCAOB engagements.

Workpaper review

Separately, the lead auditor may select certain workpapers to review. This may be in the heightened risk areas discussed above or in other areas deemed appropriate by the lead auditor. Based upon AS 1201.B2c which states the lead auditor should “[d]irect the other auditor to provide for review specified documentation with respect to the work requested to be performed,” we expect additional workpapers of the other auditor may be subject to review by the lead auditor compared to today. In determining which specific documentation (i.e., workpapers) should be reviewed, we support the lead auditor’s use of a risk-based approach, including the lead auditor’s consideration of their familiarity with the other auditors and if the firm is part of the same network of firms.

The release text describes the lead auditor could determine it necessary to review areas of heightened risk of material misstatement or work performed by less experienced other auditors.⁵ While we agree an area of heightened risk can be part of the lead auditor’s considerations, this statement could be read that, regardless of who has reviewed the work at the other auditor, the lead auditor should consider reviewing work performed by less experienced other auditors in areas of lower risk. As stated earlier, we believe the lead auditor should be able to leverage the review and supervision performed by the engagement partners and managers of the other auditor; therefore, consideration of who reviewed the work at the other auditor should be the lead auditor’s focus, and not who performed the work. This would be consistent with AS 1201.04 allowance of assistants.

⁴ See page A4-37

⁵ See page A4-34



We also note the proposed requirement in AS 1215.19A for the lead auditor to document a list of additional other auditor workpapers reviewed by the lead auditor but not retained by the lead auditor. We agree with the Board's decision to not require the lead auditor to make a list of all documents in the other auditor's files, including those not reviewed by the lead auditor. However, there may be practical challenges for which guidance would be helpful on how to implement in documenting review of workpapers of the other auditor.

For instance, it is important the Board acknowledge other auditors outside of the United States may document their workpapers in a local language because that is what they're most comfortable with (or is required by their local law) and therefore helps promote audit quality. In order to facilitate the lead auditor's review of these workpapers, the other auditor may need to document in a language other than their primary language, or the lead auditor would need to rely on translators, either of which may adversely impact audit quality and introduce unnecessary costs. Similarly, the Board acknowledges privacy laws of certain jurisdictions may create obstacles for the transfer of the other auditor's documentation from the country in which the other auditor is located to the lead auditor's country.⁶ These challenges should not be underestimated.

For these situations, we recommend the Board provide the ability for the lead auditor to perform alternative procedures compared to a review of the workpapers. For example, alternative procedures could include allowing the lead auditor to satisfy its responsibilities through discussion with the other auditor or through use of technology in viewing workpapers in which the other auditor discusses the workpaper or certain aspects of the workpaper with the lead auditor. The lead auditor would then document the alternative procedures performed and the results of the procedures. We believe this will help minimize the risk of incorrect translation and avoid unnecessary obstacles or costs created by local privacy laws. If it is expected the lead auditor will review the workpapers in another language or cannot overcome the obstacles for the transfer of the workpapers, then translators may be needed and the lead auditor may need to travel to the locations of the other auditors. Depending on the number of locations and areas for which the workpapers are selected to be reviewed, this could result in a significant time commitment leaving the lead auditor with less time to focus on the heightened risks in the areas they are directly responsible for. We believe this could have a negative impact on audit quality instead of enhancing audit quality. If the Board believes alternative procedures are not warranted, the Board may also want to consider additional outreach related to the severity of these challenges.

Another challenge is the lack of clarity as to what might be defined as a "review." The lead auditor may look at a number of workpapers or portions of a workpaper in gaining an understanding of an issue and determining which workpapers are most important. In doing this, the lead auditor may direct the other auditor to provide specified documentation for review.⁷ It is not clear if this initial consideration would be defined as a "review" for which documentation is needed. Additionally, the lead auditor may look at a workpaper to understand the nature, timing and extent of the work to be performed, but not review the results of the actual work. To clarify, we recommend documentation of which workpapers and, where relevant, which portions of workpapers have been reviewed be required once the lead auditor has decided the area of the work or the specific workpaper is necessary to review based on the assessed risk.

⁶ See page A4-26

⁷ AS 1201.B2c requires in supervising the work of other auditors, the lead auditor should direct the other auditor to provide for review specified documentation with respect to the work requested to be performed



Multi-tier audits

AS 1201.B3 requires the lead auditor to remain responsible for directly communicating to all other auditors (including second other auditors in a multi-tier engagement) the scope of work to be performed, tolerable misstatement,⁸ identified risks of material misstatement and amounts below which misstatements are clearly trivial.

In a multi-tier situation, the first-tier other auditor, who may be more familiar with the consolidation at its level, might be in better position to consider the scope of the work to be performed, identification of the risk of material misstatement, and the tolerable misstatement for second-tier other auditors reporting to them. As written, the standard appears to require the lead auditor to make those determinations. Instead, we would support communication of those decisions by the first-tier other auditor to the lead auditor as part of its supervision of the first-tier other auditor.

Planning - individuals

We have noted the proposed definition of “other auditors” includes individuals, and not just the firm for whom they work. As a result of the proposed definition, it would appear the lead auditor would be required to determine, for each team member of the other auditor, the individual’s knowledge of SEC and PCAOB independence and ethics requirements, their experience in applying the requirements, and obtain a written representation from each of them in accordance with AS 2101.B4, instead of relying on the understanding of the firm’s process and allowing the other auditor to monitor individual compliance. This would also appear to require the lead auditor to develop a process to monitor changes in the engagement team at the other auditor level in order to determine whether they have identified every engagement team member spending time on the audit. Proposed AS 2101.B6a would also require the lead auditor to gain an understanding of the knowledge, skill and ability of the other auditors who assist the lead auditor with planning or supervision.

We agree enhancements could be considered in this area, but having the lead auditor perform these activities at the same level as is done for those working directly for the lead auditor as part of the lead auditor’s firm could distract from other important areas of the audit. Today, this is often performed at the firm level, with the other auditor’s engagement partner confirming to the lead auditor on behalf of their firm and team, which seems like a more appropriate approach. In order to enhance the current procedures, we would also support the lead auditor’s consideration of relevant network information, if applicable, and publicly available information related to an individual’s or firm’s independence and competency, such as SEC or PCAOB enforcement actions and PCAOB inspection reports.

Planning - firm level

Proposed AS 2101.B4 describes the lead auditor should determine each other auditor’s compliance with the SEC and PCAOB independence and ethics requirements by gaining an understanding of each other auditor’s knowledge and experience in applying the requirements and obtaining a written representation. While we agree such procedures are appropriate, we have concerns the lead auditor’s ability to “gain an understanding” may be impacted by whether or not the other auditor is a member of the same network as the lead auditor. We suggest the PCAOB provide guidance on how firms are expected to perform these procedures when the other auditor is not a member of the same network, as well as guidance on how much

⁸ Separately, in response to Question 3 on page 24, we do not believe it necessary to provide more specific guidance for determining tolerable misstatement for individual locations or business units under AS 2105



additional understanding is necessary when the other auditor is part of the same network and is expected to comply with network level independence and ethics policies and guidance. When the other auditor is not a member of the same network, we would support the lead auditor's consideration of relevant publicly available information about the other audit firm, such as SEC or PCAOB enforcement actions or, to the extent relevant, PCAOB inspection reports. If the firms are members of the same network, the level of effort can be based upon whether the firms have a similar methodology, training, and monitoring process related to these areas.

Determination to serve as lead auditor

The proposed requirement in AS 2101.B2 describes a requirement for the engagement partner to determine whether the participation of his or her firm is sufficient to carry out the responsibilities of a lead auditor. In making this determination, the engagement partner should take into account 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 (which includes considering the portion's materiality) in comparison with the portions for which the other auditors and referred-to auditors perform audit procedures.

The proposed requirement could be read to indicate the only consideration in the lead auditor's determination is the proportion of the financial statements audited by the lead auditor compared to other auditors and referred-to auditors (i.e., quantitative in nature only). It is also difficult to determine from the standard if that comparison is done individually (the lead auditor should have a greater proportion than any other auditor) or in the aggregate (the lead auditor should have a greater proportion than all other auditors combined). In fact, if the latter, it is possible to imagine scenarios in which no audit firm can be viewed as the lead auditor. It is our experience that, due to qualitative reasons, the firm in the best position to be the lead auditor may not audit the largest portion of the financial statement line items individually or in the aggregate. The release text seems to acknowledge this notion.⁹

We believe the examples in Appendix 4 are very helpful in clarifying the intent of the Board. In particular, Example 2 on pages A4-16 and 17 is a practical example wherein the lead auditor audits less revenue (only 10%) than some other auditors at other locations but, for the qualitative reasons described in the example, it is determined the firm can still be the lead auditor. While we believe this example is appropriate, we are concerned the thought process described by the example may not be clear through the words in the proposed amendment.

In order to clarify the proposed amendment, we recommend certain of the language from Appendix 4 be brought into the standard, including the statement "the lead auditor ordinarily would need to audit the location at which the primary financial reporting decisions were made and the consolidated financial statements were prepared in order to address the risks related to those important judgments and activities, and a sufficient number of other locations to cover a greater portion of the risks than any of the other audit firms performing procedures on the audit."¹⁰ We also recommend clarifying that the "greater portion of the risks" relates to any other individual auditor, and not all other auditors combined. We believe including this language in the standard and continuing to publish the examples will help clarify the Board's intent.

⁹ See, for example, page A4-15, which states that the lead auditor ordinarily would need to audit the location at which the primary financial reporting decisions were made and the consolidated financial statements were prepared and a sufficient number of other locations to cover a greater portion of the risks than any of the other audit firms

¹⁰ See page A4-15



Other topics

Short-term personnel sharing arrangements

With regard to Question 17¹¹ regarding short-term (several months) personnel sharing arrangements, during which some available personnel are seconded to other firms and function as their employees, and some firms contract with consulting firms or temporary workforce agencies for personnel that work alongside and in the same capacity as personnel on the engagement team that are employed by the lead auditor, these employees, while perhaps still employed by a different firm, are in fact integrated into the lead auditor's engagement team and supervised by the lead auditor. As a result, we believe these individuals should be treated as part of the lead auditor.

Amendments to AS 1301

The proposals amend AS 1301 to require the lead auditor to communicate the basis for the engagement partner's determination that the participation of the lead auditor is sufficient to serve as lead auditor in any audit involving other auditors or referred-to auditors. We recommend this not be required in all cases, particularly when such a determination is evident. We recommend instead maintaining the current requirement, to make this communication if *significant* parts of the audit are performed by other auditors. We believe from an oversight perspective this is when the audit committee would want to engage with the lead auditor regarding the lead auditor's determination.

Divided responsibility

In question 51,¹² the Board notes a potential for increased use of divided responsibility, and questions if this should be prohibited or otherwise limited. We do not believe it should be prohibited or limitations should be placed on an auditor's ability to divide responsibility. This model is typically used in other circumstances than those noted in the question (equity method investees or when referred-to auditor covers only a small portion of the consolidated assets or operations), such as a recent acquisitions, and use in these situations may help improve audit quality as the predecessor auditor has a more immediate understanding of the business and risk of the acquired company.

Amendments to AS 2410

The proposed changes to AS 2410.16c could be misread as only requiring the auditor to communicate to referred-to auditors, as the phrase "other auditors" has been eliminated. Although "other auditor" is within the proposed definition of "engagement team," it may be more clear to auditors, and help avoid missteps, if the amendment more specifically added a reference to "other auditors," as follows:

Promptly communicate to appropriate members of the engagement team, including other auditors, and the referred-to auditor relevant information about the related party or relationship or transaction with the related party.

¹¹ See page A4-12

¹² See page A4-55



Amendments to AS 2201

The amendments to AS 2201.C11 describe requirements to refer to the report of the referred-to auditor in the lead auditor's opinion on the company's internal control over financial reporting. To be consistent with the requirements of the proposals, we suggest adding that the lead auditor should reference the name of the referred-to auditor as well.

Application to brokers and dealers and emerging growth companies

We believe the proposed amendments should apply to audits of brokers and dealers and emerging growth companies and see no reason to exclude those audits.

* * * * *

We appreciate the opportunity to express our views and would be pleased to discuss our comments or answer any questions that the PCAOB staff or the Board may have. Please contact Leonard L. Combs (973-236-5265) or Neil A. Weingarten (617-530-6225) regarding our submission.

Sincerely,

PricewaterhouseCoopers LLP



July 28, 2016

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street N.W.
Washington, D.C. 20006-2803

RSM US LLP

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Re: PCAOB Rulemaking Docket Matter No. 042

Dear Office of the Secretary:

RSM US LLP appreciates the opportunity to offer our comments on the PCAOB's *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard, "Dividing Responsibility for the Audit with Another Accounting Firm."* RSM US LLP is a registered public accounting firm serving middle-market issuers, brokers and dealers.

With respect to audits involving other auditors, we support a risk-based supervisory approach focused on significant risks to the consolidated financial statements. However, certain aspects of the proposal could be interpreted as requiring the lead auditor to perform certain supervisory procedures without consideration of whether such procedures are responsive to the identified significant risks¹. As discussed below, we believe there are additional opportunities to further promote a principles-based focus on the significant risks, while also allowing the lead auditor to exercise professional judgment in varying the nature, timing and extent of supervisory activities so as to provide for a more effective and efficient audit.

When other auditors participate in an audit, it also is important to appropriately determine the sufficiency of the participation in the audit by the lead auditor to serve as lead auditor. We support the provision of additional direction to help the lead auditor assure that its participation in the audit is sufficient for it to carry out its responsibilities. The level of interaction between the lead auditor and other auditors is critical to audit quality. We note, however, that the proposal is focused solely on the requirements of the lead auditor and suggest the Board clarify the responsibilities of the other auditor. We therefore agree that enhancements to the auditing standards guiding the supervision of other auditors are needed to help drive increased communication, especially written communication, between the lead auditor and other auditors.

Our comments with respect to the proposed amendments relating to the supervision of audits involving other auditors address potential enhancements to the risk-based supervisory approach, the lead auditor concept, the responsibilities of the other auditor, and communication between the lead auditor and other auditors. We also have included comments regarding the proposed auditing standard – AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*.

¹ See page 41 of the proposal: "...because lead auditor personnel would be required to perform additional supervisory responsibilities, such team members might have less time to perform other work on the same engagement. This could potentially reduce the likelihood that the auditor detects material misstatements in the portion of the financial statements for which the lead auditor performs procedures and could potentially lead to inefficient allocation of audit resources."

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A risk-based supervisory approach

Evaluation of competence and objectivity of the other auditor

As proposed, the standard does not contemplate consideration of the competence and objectivity of the other auditor in assessing the supervisory approach. We believe it would be helpful if the standard would establish criteria for the lead auditor to use in considering the competency and objectivity of the other auditor so as to vary the nature, timing and extent of supervisory activities as appropriate. Such criteria could include:

- The lead auditor's knowledge of the other auditor, including its relevant industry experience and system of quality control
- The lead auditor's experience working with the other auditor on prior audits
- Whether the other auditor team includes a U.S. audit partner or manager on a long-term expatriate assignment
- The regulatory environment of the other auditor and whether it is similar to that in the United States

Also, the proposed standard makes no distinction between the supervisory requirements for other auditors from the same global network of firms as the lead auditor and those for other auditors outside the network. We believe this lack of differentiation could create additional effort when network firms participate in the audit, which would not improve audit quality and would result in additional costs for the audit client. For example, ignoring a network firm's system of quality control that is operating effectively could cause a duplication of effort between the lead auditor and the other auditor, especially related to evaluating independence, technical training and performance of members of the engagement team.

Obtaining an understanding of independence and objectivity

Under current standards, the determination of whether the other auditor has complied with the SEC and PCAOB independence and ethics requirements is made at the firm level. Proposed Appendix B of AS 2101, *Audit Planning*, states, "In an audit that involves other auditors, the lead auditor should determine each other auditor's compliance with the SEC and PCAOB independence and ethics requirements..."² The proposed definition of "other auditor" in AS 2101 includes "a member of the engagement team who is not a partner, principal, shareholder, or employee of the lead auditor..."³ Therefore, we believe the proposed requirement to determine "each other auditor's" compliance with the SEC and PCAOB independence and ethics requirements would result in the need for the lead auditor to obtain an understanding of *each* team member's knowledge of independence and ethics requirements and to obtain a written representation regarding compliance with those requirements from *each individual engagement team member* of the other auditor. This would be unwieldy and costly, especially when the other auditor is not part of the lead auditor's global network. It also could be impossible to obtain in jurisdictions where privacy laws could impede sharing of detailed information about an individual. We suggest the proposed requirements in Appendix B of AS 2101 be revised to allow the other auditor's engagement partner to confirm to the lead auditor compliance with the SEC and PCAOB independence and ethics requirements on behalf of their firm and engagement team.

² See paragraph .B4 of Appendix B, *Additional Requirements for the Lead Auditor When Planning an Audit that Involves Other Auditors or Referred-to Auditors*, on page A1-15 of the proposal.

³ See paragraph .A5.a. of Appendix A, *Definitions*, on page A1-13 of the proposal.

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Review of other auditor's documentation

Proposed paragraph .B2.b. of AS 1201, *Supervision of the Audit Engagement*, requires the lead auditor to "Obtain and review the other auditor's description of the nature, timing, and extent of audit procedures to be performed..."⁴ We believe this new proposed requirement would involve the performance of a review at a level of detail that may not be necessary or effective in all circumstances. For example, it may not be necessary for the lead auditor to obtain the entire audit program from the other auditor when the other auditor performs a full-scope audit for statutory purposes. We believe a more effective and efficient risk-based approach would instead be limited to requiring the lead auditor to obtain and review the other auditor's description of the nature, timing and extent of audit procedures to be performed in higher risk areas.

Likewise, proposed paragraph .B2.d. of AS 1201 would require the lead auditor to "Obtain from the other auditor a written report describing the other auditor's procedures, findings, conclusions, and, if applicable, opinion..."⁵ We believe this new proposed requirement could be read to require each step performed by the other auditor to be summarized. We believe a more effective and efficient risk-based approach would instead be limited to requiring the lead auditor to obtain a written report describing the other auditor's (a) procedures performed in higher risk areas, together with related findings and conclusions, and (b) opinion, if applicable.

Review of other auditor's work

In discussing the requirement to direct the other auditor to provide specific documentation, the proposal states, "...the lead auditor could determine it necessary to request additional documentation for review with respect to the work performed by less experienced other auditors..."⁶ This could be interpreted to mean that the lead auditor should consider the experience of the person who performed the work, without regard to the experience of the person who reviewed the work. We believe a more effective and efficient lead auditor's review would focus on the experience level of the person who reviewed the work performed by the other auditor, rather the experience level of the person who performed the work.

Proposed paragraph .19A of AS 1215, *Audit Documentation*, would require audit documentation of the office issuing the auditor's report to include "a list of additional work papers of other auditors...that were reviewed by the lead auditor but not retained..." Further, such a list "must include a description of the work papers reviewed, the reviewer, and the date of such review."⁷ We believe a list that includes the work paper title and reference number or audit step name would suffice to document which work papers or audit steps were reviewed by the lead auditor. The other auditor would be required to retain the work papers, so the proposed requirement to include a description of the work papers reviewed would be unnecessarily duplicative.

Determination of the lead auditor

As stated above, we agree that it is important to appropriately determine the sufficiency of the participation in the audit by the lead auditor to warrant serving as lead auditor. However, we are concerned that the proposed definition of "lead auditor" in AS 2101 may be too narrow as it currently only

⁴ See paragraph .B2.b. of Appendix B, *Procedures to Be Performed by the Lead Auditor with Respect to the Supervision of the Other Auditors' Work*, on page A1-23 of the proposal.

⁵ See proposed paragraph .B2.d. of Appendix B, *Procedures to Be Performed by the Lead Auditor with Respect to the Supervision of the Other Auditors' Work*, on page A1-23 of the proposal.

⁶ See proposed paragraph 3 on page A4-34 of the proposal.

⁷ See proposed paragraph .19A of AS 1215 on pages A1-27 and 28.

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includes “the engagement partner and other engagement team members who...are partners, principals, shareholders, or employees of the registered public accounting firm issuing the auditor’s report...”⁸ Given the variety of accounting firm structures, we believe situations will exist where the lead auditor is sufficiently involved such that the other auditor becomes an extension of the lead auditor and is not working independently without direct supervision. Therefore, we suggest the definition of “lead auditor” be broadened to include engagement team members who are supervised directly by the lead auditor engagement partner or designee.

Responsibilities of the other auditor

The proposal focuses solely on the requirements of the lead auditor. We believe the proposal should include a statement that the other auditor bears responsibility for the performance of their own work and their own report, if applicable. Also, we suggest the Board develop a risk-based, principles-based framework within the proposal to clarify the responsibilities of the other auditor, including the responsibilities of the senior engagement team members of the other auditor. Such responsibilities would not detract from the overall responsibility of the lead auditor, but rather should improve audit quality by emphasizing the responsibilities of the other auditor.

Lead auditor communications

Tolerable misstatement

Proposed paragraph .B2.a. of AS 1201 requires the lead auditor to “Inform the other auditor of...tolerable misstatement”⁹. It appears it is the Board’s intention to require the lead auditor to inform the other auditors of the “tolerable misstatement for the location or business unit.”¹⁰ Therefore, we suggest that paragraph .B2.a. be revised to specify that the required communication is the tolerable misstatement for the location or business unit.

Identified risks of material misstatement

Proposed paragraph .B2.a. of AS 1201 also requires the lead auditor to “Inform the other auditor of...the identified risks of material misstatement.”¹¹ We believe a risk-based approach would not require the communication of all identified risks of material misstatement because not all identified risks of material misstatement will necessarily be applicable to a particular location or business unit and therefore could unintentionally require additional procedures by the other auditor. We suggest instead requiring the lead auditor to inform the other auditor of identified *significant* risks of material misstatement *at the entity and business unit level*.

Dividing responsibility for the audit with another accounting firm

We agree that it is logical to have a separate standard related to dividing responsibility for the audit with another accounting firm. We note, however, that proposed AS 1206 only addresses the requirements to be followed when making reference to another auditor. There is no guidance on whether to make

⁸ See paragraph .A4.b. of Appendix A, *Definitions*, on page A1-13 of the proposal.

⁹ See paragraph .B2.a. of Appendix B, *Procedures to Be Performed by the Lead Auditor with Respect to the Supervision of the Other Auditors’ Work*, on pages A1-22 and 23 of the proposal.

¹⁰ See page A4-31 of the proposal.

¹¹ See paragraph .B2.a. of Appendix B, *Procedures to Be Performed by the Lead Auditor with Respect to the Supervision of the Other Auditors’ Work*, on pages A1-22 and 23 of the proposal.

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reference to another firm, which could infer that such considerations no longer are appropriate. For example, under extant AU 543.05-06, a firm generally does not make reference to another firm in its global network. Also, there may be situations in which it may be impractical for the lead auditor to take responsibility for the other auditor's work. Therefore, we believe guidance should be provided regarding considerations in deciding whether to make reference to another auditor.

Also, provided certain conditions are met, existing standards allow for dividing responsibility when financial-reporting frameworks are different. The proposed standard does not allow for division of responsibility when financial-reporting frameworks are different, and we believe this is an important option that should be allowed to accommodate situations in which a foreign subsidiary's financial statements are prepared in accordance with International Financial Reporting Standards and audited by an other auditor and the consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles.

We would be pleased to respond to any questions the Board or its staff may have about our comments. Please direct any questions to Sara Lord, National Director of Assurance Services, at 612.376.9572.

Sincerely,

RSM US LLP

RSM US LLP



July 27, 2016

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, D.C. 20006-2803

RE: PCAOB Release No. 2016-002: Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Accounting Firm.

To Whom It May Concern:

One of the expressed goals of the Texas Society of Certified Public Accountants (TSCPA) is to speak on behalf of its members when such action is in the best interest of its members and serves the cause of Certified Public Accountants in Texas, as well as the public interest. The TSCPA has established a Professional Standards Committee (PSC) to represent those interests on accounting and auditing matters. The views expressed herein are written on behalf of the PSC, which has been authorized by the TSCPA Board of Directors to submit comments on matters of interest to the committee membership. The views expressed in this letter have not been approved by the TSCPA Board of Directors or Executive Board and, therefore, should not be construed as representing the views or policy of the TSCPA.

We have chosen to direct our response to this ED by focusing on what we consider to be the four important issues addressed in this document. The four aspects we wish to address are: (1) our overall reaction to the amendments included in the document, (2) the alternative approaches that the Board considered but is not proposing, (3) some economic considerations associated with the proposal that the Board should address, and (4) the need for further research on issues that are in need of further clarification.

We are in agreement with the Board's efforts to address issues that are designed to enhance audit quality. The basic issues addressed in this proposal need to be examined as they strongly impact the potential quality of audit engagements, as well as the audit process. The Board has taken a broad look at the process of audit supervision and audit responsibility. We are in agreement with the direction of this proposal and believe, with further study, it will prove to be a great benefit to the audit process both in quality of performance and appropriateness of responsibility.

We have some concern regarding the alternative approaches that the Board considered but is not proposing. The Board considered but did not propose requiring the lead auditor to gain an understanding of the qualification of all engagement team members outside of the lead auditor's firm. AU 543 currently requires the lead auditor to satisfy himself/herself as to the independence and professional reputation of other auditors, including taking steps considered appropriate to satisfy the lead auditor that he/she may express an opinion on

financial statements or elements of financial statements of an audit performed by other auditors. We believe that this assessment of a firm's professional reputation and qualifications is sufficient in relying on other auditor's qualifications. Additionally, we believe it would be overly burdensome from a cost/benefit assessment to document the qualifications of every team member used by the other auditor.

The Board also considered, but is not proposing, requiring the lead auditor to determine the nature, timing and extent of audit procedures to be performed by the other auditors. Instead, the proposal would require that the lead auditor determine the scope of the work of other auditors and review the other auditor's description of the nature, timing and extent of audit procedures. We believe this is a "facts and circumstances" decision and should be determined on a risk-based approach by the lead auditor, with such risk-based assessment being appropriately documented by the lead auditor. If the lead auditor is assuming responsibility for work performed by other auditors and the work is deemed to be insignificant to the financials taken as a whole, then the proposed amendment is sufficient. However, if the lead auditor is not assuming responsibility and will refer to the work performed by other auditors in a divided responsibility audit, then we believe the amendment as proposed is sufficient. This should be clearly described in the final draft of the proposal.

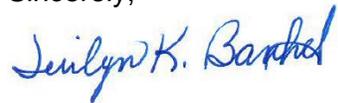
We believe the Board must consider the potential economic issues that are likely to surface as a result of cost increases likely incurred by lead auditors. Under the proposal, lead auditors would be required to perform additional supervisory responsibilities. These responsibilities will increase the costs for the lead auditor, particularly in smaller audit firms. Such costs will most likely result in an increase in the costs for the issuer as well. This will increase the issuer's cost of capital, particularly smaller issuers who cannot or will not move to larger more costly audit firms, particularly U.S. national firms that may not incur as significant an increase in costs as smaller audit firms. Some audit firms may determine that they will no longer perform audits if another audit firm is required. If they choose to perform the entire audit by themselves, they will likely incur additional personnel, travel and overhead costs. Such costs would most likely be passed on to issuers whose cost of capital would increase accordingly. Some audit firms may determine that they will no longer perform audits if another audit firm is required, due to additional supervisory responsibilities resulting in actual or perceived increased liability. This could reduce the pool of auditors available to smaller issuers, resulting in increased costs of capital when the fees of larger firms are required.

Finally, we encourage the Board to commission research that will help shed some light on the critical issues that are sure to surface as this area of shared audit responsibility continues to expand. We are not aware of additional studies (other than those referenced in the proposal) or data currently available which focus on the issues being addressed in this proposal. We agree that the lack of accessible data is a significant factor in the lack of research regarding international audits involving multiple audit firms. We do believe that additional research in this area is needed and are aware of germane academic studies which have been proposed. Participation and data from audit firms and their personnel practicing in these situations are necessary in developing relevant studies that are likely to produce useful information in crafting useful guidance. Thus, we strongly recommend that the Center for Audit Quality fund research in this area of the audit process that is going to need well-structured guidance for years to come.

We believe auditors should be given a minimum of 18 months after SEC approval of the proposed amendments and new auditing standard requirements for implementation.

We appreciate the opportunity to provide input into the standards-setting process.

Sincerely,

A handwritten signature in blue ink that reads "Jerilyn K. Barthel". The signature is written in a cursive style with a blue ink color.

Jerilyn K. Barthel, CPA
Chair, Professional Standards Committee
Texas Society of Certified Public Accountants



ICAEW REPRESENTATION

115/16

PCAOB Release No. 2016-002, April 12, 2016

Rulemaking Docket No. 042

Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard - Dividing Responsibility for the Audit with Another Accounting Firm

ICAEW welcomes the opportunity to comment on the PCAOB's Release No. 2016-002, April 12, 2016, Rulemaking Docket No. 042 *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard - Dividing Responsibility for the Audit with Another Accounting Firm* published on 12 April 2016, a copy of which is available from this [link](#).

This response of 29 July 2016 has been prepared on behalf of ICAEW by the Audit and Assurance Faculty. Recognised internationally as a leading authority and source of expertise on audit and assurance issues, the Faculty is responsible for audit and assurance submissions on behalf of ICAEW. The Faculty has around 7,500 members drawn from practising firms and organisations of all sizes in the private and public sectors.

ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 145,000 member chartered accountants in more than 155 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

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MAJOR POINTS

1. The PCAOB's inspection work highlights important issues with regard to the conduct of group audits. There are genuine difficulties for auditors associated with complex group structures, local licensing requirements, different auditing and reporting requirements, access restrictions and cultural and linguistic barriers. In particular, we appreciate the frustration experienced by lead auditors and regulators alike with structural and other limitations arising from these issues. We acknowledge that auditors sometimes fall short of the required standards in conducting group audits and that there is a real need for improvement. We therefore welcome this opportunity to respond to these proposals.

The role of standard-setting, and securities and audit regulators in improving group audits

2. Changing behaviour requires the co-operation of a number of stakeholders and a multi-faceted approach combining direction, guidance, incentives and sanctions. Above all, successfully changing behaviour requires a clear understanding of the sub-optimal status quo, the dynamics that perpetuate it, and the different courses of action available to deal with the problems. In other words, the proposals need to reflect and address root causes of the problems the PCAOB rightly identifies. The PCAOB also needs to consider how standard-setting fits in with the other courses of action needed to address them on a holistic basis.
3. On the face of it, the proposals are about 'tightening up', making sure that lead auditors are sufficiently involved in group audits, and that other auditors who are necessarily involved in group audits of any size, do what they are supposed to do. These are simple and worthy objectives and we welcome initiatives by standard-setters such as the PCAOB to break down established patterns of behaviour and to create new ways of thinking and working within and between audit firms to achieve these objectives.
4. Government, audit inspectorates and securities regulators, including the PCAOB and the SEC, have an important role to play in improving group audits. We urge them to continue their dialogue to overcome the long-term structural barriers to the improvement of lead and other auditor performance. It is asking too much to expect standard-setting alone to improve audit quality. The PCAOB in particular has a leading role to play in improving group audits in its capacity as an audit inspector and it is held in exceptionally high regard internationally. US audit inspectors are perceived as diligent. US regulatory excellence has taken a decade or more to build and its foundations are solid. Those foundations include a clear and detailed understanding of the dynamics of audit firms and audit practices and many non-US audit regulators have been modelled on the PCAOB with good reason. It is critical that the PCAOB retains this status internationally and that the strength and wisdom of the US approach are not undermined. To do this, it *must* ensure that what it does actually addresses the underlying problems with performance in group audits, and that unintended consequences are avoided. The best way to achieve this is by properly understanding the real root causes of poor performance in group audits. That, in turn, involves understanding clearly how and why group audits are conducted in the way that they are.

Understanding the root causes of poor auditor performance is not easy, but it is the only way to improve it

5. Some of the root causes of poor auditor performance are not obvious, there are many of them, their specific effects are hard to isolate and not all of them can be remedied by auditors and the PCAOB. Poor quality staff and audit methodologies, insufficient resources generally and inadequate training in particular can all be addressed, as can structural disincentives within firms. But the complex regulatory, legal and commercial infrastructure is also an important contributory factor. If this is not acknowledged, change is likely to be of limited value. It is therefore particularly important to work *with* auditors on the logistics of group audits that reflect complex group structures.

6. The PCAOB's observations regarding the hazards involved in inadequate supervision of other auditors are real. Some of the proposed solutions, however, have an administrative feel to them and, despite assertions regarding the risk-based nature of the proposals, are highly prescriptive in a number of important respects. In short, some of the proposals seem primarily designed to improve ease of inspection, and we are concerned that they will have little substantive effect on the performance of group audits. In particular, we doubt that some of the additional documentation requirements and confirmation of compliance with current requirements (such as the adequacy of involvement) will, of themselves, improve the quality of procedures performed, whether by lead or other auditors.

Working constructively with other audit regulators, and with experienced and competent local auditors

7. We believe that the International Forum of Independent Audit Regulators (IFIAR) has the potential to play a vital role to play in co-ordinating the oversight of cross-border audits and that it is in a unique position to add value to group audits. We encourage the PCAOB to engage in a dialogue with IFIAR to develop its potential in this respect. In order for IFIAR to fulfil its role, it too needs to acknowledge that companies and their auditors now operate on a regional and business line basis. Questions regarding how lead auditors in the US deal with auditors from a particular jurisdiction no longer make sense in isolation – it is just as important to understand how non-US 'other' auditors manage and supervise second 'other' auditors in the regions for which they take responsibility in group audits. IFIAR is in a unique position to approach the review of group auditors in this manner.
8. Reports of audit regulators from around the world note situations in which instead of working constructively with experienced and competent other auditors, lead auditors send inexperienced staff into locations that they do not understand economically, culturally or linguistically, and instruct them to perform work appropriate in the lead auditors jurisdiction. As a result, not very surprisingly, they fail to perform a proper risk assessment. But regulators too often encourage this behaviour by making general assumptions about the value of different types of evidence in group audits. Auditors note that the first question regulators often ask are about visits to group companies and other auditors. Visits to other auditors or the entities they audit can be wasted if the purpose of the visit is not clearly thought out, the visit is poorly managed, if it is too short, undertaken for the sake of appearances, and if those sent are poorly briefed or are insufficiently experienced to deal with unprepared or hostile hosts. But such visits *are* often performed in the belief that regulators are less likely to question such an approach, than they are a decision to review files, which is too often interpreted as a cost management exercise.
9. The PCAOB refers to academic evidence suggesting increased coordination and communication challenges in geographically distributed work. The apparent obviousness of this aside, we are deeply concerned that the PCAOB appears to believe that such conclusions support the avoidance of such situations. Concerns about the ability of non-US firms to apply US GAAP and GAAS may be well founded in some cases. However, simply sending US nationals abroad to perform the work instead creates as many if not more serious problems than it solves, particularly if, as seems at least possible in many cases, those sent cannot speak the local language, cannot read the files and have superficial understanding of local business, regulatory and cultural norms. The ability of such staff to assess risk adequately is questionable at best. The potential cost of this to US investors is substantial.
10. The main thrust of the section on multi-layered audits appears to deal with situations in which it is appropriate to bypass other auditors at the head of a layer, going directly to other auditors at a lower level. In a few cases this may be appropriate but we are dismayed by the lack of focus on how to use these mezzanine auditors to better effect. Auditors currently have little practical choice but to work with such auditors and the proposals will not change that.
11. The overall impression given reading the proposals is that that the PCAOB regards firm and network-wide quality controls as untrustworthy, and believes that lead auditors should trust no-

one unless they have no choice, and that they should seek to perform the work themselves wherever possible. This approach seem to ignore, a number of structural issues that standard-setting cannot address. We urge the PCAOB to take a more nuanced and intelligent approach to these difficult issues. Investments made by network firms to improve common standards should enable lead auditors to make some use of the overall systems of quality control within such networks.

US investor interests

12. For all of the reasons set out above, we fear that if the proposals are implemented without further consideration, they risk not improving US investor interests because they may hamper audit quality in the manner described above, and because they may have a chilling effect on competition between firms. The pressure to use one firm of auditors throughout the group, which is often far from ideal from an audit quality angle, seems likely to be increased, particularly where mandatory auditor rotation is now in place. While more work would undoubtedly be performed and cost incurred, we are genuinely struggling to see the benefits in terms of improved audit quality in several important respects;
- we challenge the PCAOB to properly reconcile its assertion that it is achieving its objectives through a risk based approach. The risk-based supervisory approach appears to be circumscribed: the risk assessment, which is already performed on the financial statements, is curtailed in the proposals and cannot be extended to the risks associated with the use of other auditors' work, not least as a result of the emphasis on direct communication with lower tiers of other auditors and in particular, making the lead partner directly responsible for the supervision and review of the entire group audit;
 - the development and application of quality control standards, both within firms and across networks, driven to a great extent by audit regulators, has been critical in enhancing audit quality the last fifteen years. Lead auditor work on the quality control standards of other auditors is key to the approach to many if not most large group audits. We do not question the need for improvement in the application of those standards, but we are perplexed by these proposals because while they acknowledge the importance of quality controls, they appear to dismiss their value almost entirely by effectively, if not explicitly, encouraging auditors to bypass auditors who co-ordinate other auditors by requiring direct communicating with lower tier auditors;
 - some aspects of the proposals regarding documentation seem unrealistic. Many attempts have been made in the past to exclude oral communication from audit evidence. They have failed because the presumption that only what is recorded in writing can be admitted as evidence is simply unworkable. It is wholly unrealistic to expect audit files to stand alone, to survive a 'nuclear attack'. Audit quality policies and procedures implemented at the firm level cannot and should not be duplicated on every file, not only because it is clearly a waste, but because the need to do so takes up valuable time that could be better spent on substantive issues. Some contextual explanation will always be required and auditors should not be encouraged to treat audit files as if their primary purpose was to act as defence documents in litigation.

Group audits and the supervision of other auditors are important, and we appreciate the PCAOB's diligence

13. In the light of the observations above, we believe that it is right and proper for us to suggest an alternative approach to the important issues the PCAOB raises. While ICAEW is a long-time supporter of the convergence of global auditing standards, on this occasion we do not suggest that the PCAOB should take the same approach as the IAASB to these issues. However, IAASB will likely revise ISA 600 in the foreseeable future and we urge both standard-setters to seek common ground wherever possible. We do not suggest that the PCAOB should adopt the IAASB's 'bottom up' component model with regard to group audits but consideration should be given to the need for a truly risk-based approach. As well as dealing with detailed requirements

for supervision, the PCAOB should also deal with how auditors scope group audits, how resources are deployed to execute the audit and the strategy that should be put in place to supervise such work. This standard on the supervision of other auditors can reflect a proper risk assessment to accommodate the many and varied approaches possible to group audits.

14. The standard should as a minimum:

- require lead auditors to set out the specific risks involved in a group audit engagement;
- set out factors for lead auditors to consider in performing the risk assessment;
- set out considerations regarding how lead auditors go about performing the assessment;
- require lead auditors to document their strategic approach to group audits.

15. Such an approach should reflect what firms currently aim to do. It does not represent the status quo in terms of auditing standards, because as the PCAOB acknowledges, most larger firms do more than what is currently required by the PCAOB, and by ISA 600, as evidenced by the IAASB's ITC *Enhancing Audit Quality*, and the responses thereto.

16. Group audits and the supervision of other auditors are far from straightforward issues, but they are important and we appreciate the time and effort standard-setters, including the PCAOB, are devoting to this area.

RESPONSES TO SPECIFIC QUESTIONS

We have not answered specific questions on issues that arise from PCAOB inspections and/or are specific to the US where our members have less exposure to such matters.

A: Discussion of proposed amendments, economic analysis, emerging growth companies and broker dealers – pages 1-54, questions 1-15

Q1: Does the description of existing audit practice accurately depict the state of practice? Does the discussion of the reasons to improve auditing standards sufficiently describe the nature of concerns arising from the use of other auditors that the Board should address? Are there additional concerns that the Board should seek to address?

17. Thirty years ago, when the complex group structures prevalent today were relatively rare, lead auditors could divide up parcels of the audit to different countries or offices, issue instructions in terms of what needed to be done for consolidation purposes, and gather information centrally. The quality controls exercised by other auditors were a peripheral issue in the majority of cases. Only a few of the very largest audits entailed some consideration of multi-layered audits.

18. Today, a high proportion of large multi-national group structures are complex and the multi-layered approach to control adopted by group companies is necessarily reflected in the way auditors approach them. Multi-layered audits are now the norm and barriers to access are more common. Group audits are now necessarily iterative, and more reliant on auditor quality controls. Auditors have of necessity developed a range of approaches to marry the resources required with those available to the best effect in any given situation. Auditors may decide to use the work of other auditors, or to send their own people in, use questionnaires, review files in their entirety or selected sections thereof, either on site or remotely, use translators in meetings with other auditors, and have schedules or reports translated. They may focus on the quality control policies and procedures in place when considering which approach to take, or they may ignore the work performed by other auditors altogether. What they do not and cannot do is to make general assumptions: it is not always better for lead auditors to perform the work than other auditors, it is not always better to visit than to review files remotely, and it is not

always better to review files than it is to use questionnaires. Auditors, as the PCAOB acknowledges, have learned from their experiences and responded.

Q2: Are these proposed amendments to existing standards appropriate? Are additional changes needed to increase the likelihood that the lead auditor is sufficiently involved in the other auditor's work? Should the Board require specific procedures to address business, language, cultural, and other differences between lead auditors and other auditors, and if so, what types of procedures?

19. The proposals state that the three areas of potential improvement in the current standards involve taking account of changes in auditing practice, applying a risk-based supervisory approach, and providing additional direction. We see the additional direction, but the proposals do not appear to acknowledge changes to auditing practice as they relate to the conduct of complex, multi-national group audits. The risk-based supervisory approach appears to be circumscribed: the risk assessment is performed on the financial statements (which in practice represents no change) but cannot be extended to the risks associated with the use of other auditors' work.
20. Furthermore, the PCAOB's own summary of the proposed amendments are entirely prescriptive in nature. They:
 - *prescribe* procedures to be performed by the lead auditor with respect to the supervision of the other auditor's work;
 - *require* that documentation includes a specified list of other auditors' working papers reviewed but not retained;
 - *require* the engagement quality reviewer to evaluate the engagement partner's determination of his or her firm's sufficiency of participation in the audit.
21. The second requirement in particular is highly prescriptive. It will undoubtedly change behaviour, provide a regulatory objective and facilitate review without reference to auditors, but we struggle to understand the current mischief it is intended to address, still less how it will improve audit quality. Understanding what has been done would be better achieved through a review of files involving a discussion with the lead auditor, particularly when the files are in a foreign language. Reviewing any files in isolation is as bad for regulators as it is for lead auditors.
22. The third requirement is not risk-based. There will be many situations in which evaluating the engagement partner's determination of the firm's sufficiency of participation is a formality. A risk-based approach would require a review only in borderline cases.
23. We agree that changes are needed to increase the likelihood that the lead auditor is sufficiently involved in the other auditor's work, but we believe that the PCAOB has gone too far in some respects and that some of the proposals may have the unintended consequence of reducing the quality controls applied. The purpose of quality control policies and procedures is to enable the use of output with reduced testing thereof. If no reduction is permitted, the purpose of the controls is called into question and the PCAOB appears to be trying to have it both ways, by requiring auditors apply quality controls in a group situation, while denying them the benefit by ignoring the output in the form of audit reports produced by other auditors. This is particularly difficult to understand given that the PCAOB specifically acknowledges that the quality controls some firms now apply go beyond the requirements of standards, particularly with regard to:
 - evaluating specific information about the education and experience of other auditors;
 - continually updating the understanding of the other auditors' qualifications throughout the audit and making any necessary adjustments to the extent of supervision;
 - communications between the lead auditor's senior engagement team members and other auditors about important matters that could affect the procedures they perform.

24. While we believe it is important for auditors and auditing standards to *acknowledge and respond* to the significant business, language, cultural, and other differences between lead auditors and other auditors, we believe that it would be difficult to enforce specific requirements to address them. Requirements that cannot be enforced, or that require significant interpretation, risk bringing the requirement into disrepute.

Q3: Are there any other areas of improvement in existing standards relating to audits that involve other auditors that the Board should address? Should the Board's standards be amended to address other responsibilities of the lead auditor? Are there related areas of practice for which additional or more specific requirements are needed, such as determining tolerable misstatement for the individual locations or business units under AS 2105?

25. Further guidance, not necessarily within a PCAOB standard, could usefully cover the *scoping of group audits* and the *application of materiality*. Both of these issues are fundamental in determining which other auditors to engage with and where audit effort needs to be focussed to ensure that a risk-based approach is taken. One possible effect of coverage of these areas might be *reduced* involvement of other auditors in group audit situations.

26. In particular, further guidance would be helpful in the following areas:

- how to determine materiality and performance materiality at component level, especially where there is a large number of insignificant components as this is an area that auditor's struggle with in practice;
- what constitutes sufficient appropriate evidence in groups where there are only non-significant components or the non-significant components represent a large proportion of the group;
- the evidential approach to shared service centres;
- qualitative considerations regarding the sufficiency of participation in the group audit.

Q4: The Board requests comment generally on the baseline for evaluating the potential economic impacts of the proposal. Are there additional academic studies or data the Board should consider? The Board is particularly interested in studies or data that could be used to assess potential benefits and costs.

Q5: The Board requests comment generally on the analysis of the need for the proposal. The Board is interested in any alternative economic approaches to analyzing the issues presented in this release, including references to relevant data, studies, or academic literature.

Q6: The Board requests comment generally on the potential benefits to investors and the public. Are there additional benefits the Board should consider?

Q7: The Board requests comment generally on the potential costs to auditors and companies they audit. Are there additional costs the Board should consider?

27. We believe costs and efforts formerly dealt with at a regional level in multi-layered audits may be pushed upwards in the chain if the requirement for the lead auditor to communicate directly with other auditors is adopted. Less detailed work will be performed by other auditors, more by lead auditors, which also leaves lead auditors less time to deal with the bigger picture. Multi-layered audit approaches are often adopted to facilitate client communication and to avoid the obvious issue of the lead auditor having an excessive number of other auditors reporting to them. We also anticipate difficulties in justifying the changes, regardless of cost or where they lie, to the audited entity. The proposed changes will set group structures and group audits out of kilter and may act as a barrier to effective communication between regional management and lead auditors.

28. The PCAOB notes that auditors incurring higher costs to implement the proposed requirements may pass at least part of those costs on to the client, implying that the PCAOB believes that firms are likely to have to absorb some costs themselves. The PCAOB is fully aware that this has a potential impact on audit quality, but it does not mention this. In any case, we do not believe that the PCAOB should pass comment on how additional costs should or are likely to be apportioned.
29. The PCAOB should address more fully the potential cost and other impacts of additional hiring requirements on smaller firms.
30. We note in our major points above the risks associated with having staff competent in US GAAP and GAAS but unfamiliar with local norms perform audit work, rather than working with other auditors, and the potential costs.
31. We urge the PCAOB to consider commissioning research on the impact of its work on choice in the audit market, which we believe is diminishing and likely to be further diminished, at least in part as a result of its enhanced requirements. The effects and costs are potentially substantial, long term and they are borne by US investors.

Q8: The Board requests comment generally on the potential unintended consequences of the proposal. Are the responses to the potential unintended consequences discussed in the release adequate? Are there additional potential unintended consequences that the Board should consider? If so, what responses should be considered?

32. We note in our answer to questions 4 to 7 above the potential impact of the PCAOB's proposals on the cost to US investors of:
- the use of US staff unfamiliar with local norms and requirements in the place of local staff;
 - reduced competition in the audit market.
33. We note in our answer to 2 above, and question 9 below, the potential for the proposals to reduce the quality controls applied by lead auditors in group audit situations.

Q9: Could the proposed requirement for lead auditor supervision diminish (or be perceived as diminishing) the other auditor's accountability for the work the other auditor performs? If so, are any changes to the proposal needed to describe the other auditor's responsibilities?

34. We note in our answer to questions 2 and 8 above the potential for the proposals to have the unintended consequence of reducing the quality controls applied by lead auditors in group audit situations. The purpose of quality control policies and procedures is to enable the use of output with reduced testing thereof. If no reduction is permitted, the purpose of the controls is called into question. Furthermore, as the PCAOB itself points out, if the work of other auditors is displaced and marginalised by work performed by lead auditors, it seems at least possible that other auditors will be less diligent in executing work performed specifically for group audit purposes.

Q10: Could the proposed requirement for lead auditor supervision induce lead auditors in some audits to divide responsibility with another accounting firm rather than supervise the accounting firm? If so, how often might this division of responsibility occur?

We have not responded to this question as it arises from PCAOB inspections and/or is specific to the US.

Q11: The Board requests comment generally on the alternative approaches that the Board considered but is not proposing, as described in this release. Are any of these approaches, or any other approaches, preferable to the approaches the Board is proposing? What reasons support those approaches over the approaches the Board is proposing?

35. We note that the Board considered the effectiveness of providing guidance or increasing inspection or enforcement effort to address concerns with the supervision of other auditors but concluded that interpretive guidance, inspections, or enforcement actions alone would be less effective in achieving the Board's objectives than in combination with amending auditing standards. We strongly support this holistic approach to changing behaviour, and we urge the PCAOB to consider innovative and co-operative approaches to inspection and enforcement as we believe there is scope for change in these areas to effect improved auditor behaviour.

36. We agree with the Board's decision not to propose:

- a requirement based on quantitative thresholds;
- additional criteria for determining sufficiency of participation based on the location of the company's principal assets, operations, and corporate offices;
- requiring lead auditors to gain an understanding of the qualifications of all engagement team members outside the lead auditor's firm.

Q12: Are there additional economic considerations associated with this proposal that the Board should consider? If so, what are those considerations?

37. We note in our main points above our belief that costs formerly dealt with at a regional level may be pushed upwards, and that we anticipate difficulties in justifying the changes generally to the audited entity. They will result in a misalignment between group structures and group audits which is unlikely to be welcomed by senior management, even if having US nationals perform more of the audit seems superficially attractive.

Q13: The Board requests comment generally on the analysis of the impacts of the proposal on EGCs. Are there reasons why the proposal should not apply to audits of EGCs? If so, what changes should be made so that the proposal would be appropriate for audits of EGCs? What impact would the proposal likely have on EGCs, and how would this affect efficiency, competition, and capital formation?

We have not responded to this question as it arises from PCAOB inspections and/or is specific to the US.

Q14: The Board requests comment generally on the analysis of the impacts of the proposal on audits of brokers and dealers. Are there reasons why the proposal should not apply to audits of brokers and dealers? Are there any factors specifically related to audits of brokers and dealers that should affect the application of the proposal to those audits?

We have not responded to this question as it arises from PCAOB inspections and/or is specific to the US.

Q15: How much time following SEC approval would accounting firms need to implement the proposed requirements?

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

B. Appendix 4 – Further Discussion and Remaining Questions

II. Terminology – Proposed Definitions

Q16: Are the proposed definitions of: (a) 'engagement team,' (b) 'lead auditor,' (c) 'other auditor,' and (d) 'referred-to auditor' appropriate? Do the proposed definitions clearly describe individuals and entities that are included in these definitions? Is it clear which

individuals or entities are not included in these definitions? If not, what changes to the proposed definitions are necessary?

39. We encourage the PCAOB to consider whether further alignment between its definitions and those of the IAASB are possible. 'Other' auditors are defined as including members of the engagement team who are not employees of the lead auditor and we note in our major points above and in our answer to question 17 below, that we believe that seconded staff should not be treated in this way. The critical issue should be who is supervising their work, not who is paying their salaries.
40. We find the definition of 'other' auditors generally confusing. On one reading, the only difference between 'other' auditors and 'referred to' auditors appears to be divided responsibility, but the definitions are substantially different. We are also unclear as to why firm shareholders are included in the definitions. Any possible simplification of these definitions would be helpful.

Q17: Some global network firms use short-term (several months) personnel sharing arrangements, during which some available personnel are seconded to other firms and function as their employees. Some firms contract with consulting firms or temporary workforce agencies for personnel that work alongside and in the same capacity as personnel on the engagement team that are employed by the lead auditor. Should these personnel be treated as part of the lead auditor?

41. The definition of other auditors encompasses individuals seconded to other offices within a firm or network. Treating London staff seconded to New York to work on a major UK audit with a NYSE listing as other auditors, as the proposals do, makes no sense. Modes of employment are more fluid than they were a generation ago and secondments are common. The legal employment status of such individuals is far less important than who is directing and supervising their work.
42. Seconded staff should be treated according to how they are supervised, not according to who pays their salaries.

Q18: Are there any situations in practice where applying the new definitions of 'engagement team' and 'other auditor,' including related requirements, would present practical challenges?

43. We note in our major points above and in our answer to questions 16 and 17 above our belief that staff seconded within firms and network firms should be treated according to whom is responsible for supervision of their work and not their legal employment status.

Q19: Should there be requirements for the lead auditor to: (1) specifically identify the engagement team members responsible for assisting the engagement partner of the lead auditor in fulfilling his or her supervisory responsibilities and (2) document such assignments? Should the individuals who assist the engagement partner with supervision be limited to engagement team members from the office issuing the auditor's report?

44. We believe that a requirement for lead auditor to specifically identify the engagement team members responsible for assisting the engagement partner of the lead auditor is unnecessary, and that the suggestion that it is needed is predicated either on an unjustified level of mistrust, or in the belief that the primary purpose of the audit file is preparation for inspection.
45. Supervision should not be limited to those in the office issuing the auditor's report because it is unlikely that that office will have a monopoly on competence and quality control. We note in our major points above our sense that the proposals are underpinned by a belief that lead auditors should trust no-one unless they have no choice, and that they should seek to perform the work themselves wherever possible. This approach is simply unworkable in modern audits.

Q20: To emphasize the importance of assigning the proposed planning and supervision requirements to personnel with the appropriate qualifications in audits involving other auditors, the proposed definition of 'lead auditor' references existing standards that describe making appropriate assignments of engagement responsibilities. Does this reference appropriately address the responsibility to seek planning and supervision assistance from qualified engagement team members in these situations?

46. References to existing standards that describe making appropriate assignments of engagement responsibilities are sufficient. There is no need for the PCAOB to explain further or repeat itself. Repetition, and saying the same thing again using slightly different words, is less likely to change auditor behaviour than robust inspection and enforcement of words that are already clear.

III. Proposed Amendments to AS 2101

Q21: The proposed requirements for determining whether a firm's participation is sufficient for it to serve as the lead auditor depend on the risks of material misstatement associated with the portion of the financial statements audited by the firm. (These requirements would apply regardless of whether the other auditor is from the same audit network as the lead auditor.) Should the Board consider alternative or additional criteria for determining whether a firm's participation is sufficient? For example, should the Board impose a quantitative threshold or specify criteria covering the locations of the company's principal assets, principal operations, or corporate offices? How would such criteria help address specific issues in practice?

47. We believe that some of the criteria the PCAOB is proposing for determining whether the firm's participation is sufficient are unworkable and for these reasons we believe that the PCAOB has no alternative but to require auditors to use their judgement regarding sufficiency of participation.
48. The PCAOB lists examples of information from the other auditor that may be relevant to the lead auditor's understanding of the other auditors' knowledge of the SEC and PCAOB independence and ethics requirements, and their experience in applying the requirements.
49. We do not question the need for lead auditors to understand the other auditors' knowledge of the SEC and PCAOB independence and ethics requirements; however, we do question what are effectively requirements as to how to go about it. The examples given are all of whole firm procedures and are not engagement specific. Even if other auditors can be persuaded to provide the information, it is not clear how lead auditors are going to substantiate it.
50. The PCAOB should recognise that sufficiency of participation cannot be looked at in isolation, and that the manner in which lead auditors interact with other auditors is critical. A key inspection finding of many audit regulators not only in the context of group audits, is that a standard approach is taken, regardless of the risk assessment. Examples should be provided not only of situations in which participation is sufficient, but of how the audit approach changes in situations in which participation is sufficient, at the lower end of the range, by comparison with the approach taken in which participation is at the higher end of the scale of sufficiency. A list of factors to *consider*, which would include local licensing requirements, would also be helpful.
51. The PCAOB's proposals focus on the audit of a large proportion of the relevant risks, but local licensing and statutory requirements focus on the consolidated financial statements. The two are often mutually exclusive because of group structures, and the proposals as they stand would mean that either no-one could serve as group auditor, or two auditors would need to be appointed in some cases, one for statutory purposes and one for PCAOB purposes.
52. The proposals would increase the number of situations in which the lead auditor for PCAOB purposes would be different to the statutory auditor. This is unsatisfactory, for reasons which

we would hope were obvious, but it is sometimes unavoidable. BP, for example, has a significant US operation but the UK listing means that the group auditor must be a UK firm. Many large businesses are registered in small countries. But these situations, in which two firms effectively sign off on the entire group should not be effectively mandated through excessive prescription of participation criteria by the PCAOB.

53. We note in our answer to question 11 above our agreement with the PCAOB's decision not to specify additional criteria for determining sufficiency of participation based on the location of the company's principal assets, operations, and corporate offices. Such criteria display a shallow understanding of risk assessment.

Q22: What are the practical challenges with applying the proposed engagement partner's determination of the firm's sufficiency of participation in the audit? What changes, if any, should be made to address those challenges?

54. In addition to the issues we raise in our answer to question 21, above, applying standards in borderline situations is likely to be challenging and we believe that the PCAOB should consider developing examples of such situations with suggestions as to how they might be resolved.

Q23: Are there situations in practice in which the proposed sufficiency determination would cause changes in the firm serving as lead auditor? If so, what are these situations? What are the potential effects of those changes, including potential effects on costs and audit quality? What changes to the proposal, if any, would mitigate these issues?

55. We note in our answer to question 21 above that if the PCAOB effectively mandates a US firm as lead auditor as a result of its proposed participation criteria, the lead auditor may not change, but there will effectively be two group auditors in some cases.

Q24: The proposed sufficiency determination would apply for audits in which the lead auditor supervises the work of other auditors and audits in which the lead auditor divides responsibility for the audit with another firm. Should there be different requirements for the divided-responsibility scenario, for example, should there be additional criteria that require increased lead auditor participation in a divided responsibility scenario? If so, what should those requirements be?

We have not responded to this question as it arises from PCAOB inspections and/or is specific to the US.

Q25: Are the proposed requirements for the lead auditor to hold discussions with and obtain information from other auditors and referred-to auditors to identify and assess the risks of material misstatement appropriate and clear? Are there any practical challenges with this requirement? If so, what are they, and how could the proposed requirements be revised to address the challenges?

Q26: Are the additional proposed requirements for the lead auditor when planning an audit that involves other auditors, which address independence and ethics; registration; and qualifications of and communications with other auditors, appropriate and clear? Are there requirements that should be added to or removed from Appendix B of AS 2101? If so, what are those requirements and why should they be included or excluded?

56. Although Appendix B refers to 'discussions' with other auditors, the tone suggests that one-way written communications are the norm. Appendix 4, paragraph .B2a in particular, states that lead auditors obtain information and does not provide for two-way communication and for other auditors to pass information regarding risk up the chain.

Q27: The proposed amendments require the lead auditor to gain an understanding of each other auditor's knowledge of the SEC and PCAOB independence and ethics requirements and their experience in applying the requirements. Are there any additional costs or practical challenges associated with this? If so, what are they, and how could the proposed requirements be revised to mitigate these issues?

Q28: Should the requirement for the lead auditor to gain an understanding of the knowledge, skill, and ability of the other auditors be limited to engagement team members who assist the lead auditor with planning and supervision?

57. The requirement for lead auditors to gain an understanding of the knowledge, skill, and ability of the other auditors should not be limited to engagement team members who assist the lead auditor with planning and supervision. However, the requirements regarding how the understanding is obtained should be less specific.

Q29: Are the proposed requirements to determine that the lead auditor is able to communicate with the other auditors and gain access to their work papers appropriate and clear? If not, what changes to the proposed requirements are necessary?

58. The requirements are clear but not particularly helpful. Examples might help.

Q30: Are the proposed amendments to the requirements for determining the locations and business units at which audit procedures should be performed clear and appropriate?

59. The proposals appear to relate to access issues rather than the focus of audit effort. More evidence is not necessarily better evidence and a laundry list of working papers reviewed will not help assess the quality of the risk assessment or conclusions.

IV. Proposed Amendments to AS 1201

Q31: Are the proposed procedures to be performed by the lead auditor with respect to the supervision of the other auditor's work appropriate and clear? If not, how should the proposed requirements be revised?

60. The proposed procedures to be performed by the lead auditor with respect to the supervision of the other auditor's work are clear but we question the value of the specific documentation and communications in writing to audit quality. We note in our major points above our belief that while some of the proposed requirements will aid inspection, they will do little to improve audit quality. They may, as we have noted in numerous responses to the PCAOB in the past, divert attention from more important issues.

Q32: Currently, AS 1205.12 describes certain procedures that the lead auditor should consider performing when using the work of the other auditor (e.g., visiting the other auditor), which are not included in the proposal. Should the lead auditor be required to perform these or any other procedures? If so, what additional procedures should be required?

61. We note in our major points above the potentially adverse effects of regulatory pressure to visit other auditors. We strongly urge the PCAOB to avoid further prescription in this area.

Q33: Are the requirements for the written report from the other auditor sufficiently clear? Are these requirements appropriately scalable to the nature and significance of the work referred to the other auditor? Would the proposed requirement for the lead auditor to obtain a written report from the other auditor result in a significant change in practice? If so, what is the estimated economic impact (e.g., costs and benefits) of this change?

62. The requirements are clear and while writing things down may focus the mind, it does not, of itself, guarantee any improve audit quality. Quality discussions and reviews of working papers may be a more effective mechanism of improving audit quality and documentation needs to be tailored to the lead auditors assessment of the quality of work performed by other auditors.

Q34: Is the scalability of the proposed supervision amendments clear and appropriate? If not, what changes are necessary? Are the proposed requirements for situations in which the lead auditor directs an other auditor to perform supervisory procedures with respect to a second other auditor on behalf of the lead auditor clear? If not, how should the proposed requirements be revised?

63. The scalability of the proposed supervision amendments is not at all clear. The statement to the effect that lead auditors are not required to review all of the other auditor's work papers to determine whether the other auditor performed its work as requested is helpful, as are the associated suggestions regarding risk and discussions, but they are very high level.

Q35: In a multi-tiered audit where the lead auditor directs the first other auditor to perform certain procedures with respect to the second other auditor, is the proposed requirement that lead auditor inform directly all other auditors of certain other specific matters appropriate? If not, how should the proposed requirements be revised?

64. We believe that the proposed requirements for lead auditors to inform directly all other auditors of certain other specific matters in addition to informing the first auditor is wholly inappropriate and displays (and indeed could be construed as encouraging) a wholly unnecessary level of distrust. We believe that the requirement should be removed.

Q36: In a multi-tiered audit, is the proposed requirement for the lead auditor to evaluate the first other auditor's supervision of the second other auditor's work clear? If not, how should the proposed requirements be revised?

Q37: Do the proposed requirements sufficiently cover the types of multi-tiered structures used today? If not, what other multi-tiered structures are used and what changes are needed to appropriately cover those situations?

Q38: Do issues exist when the lead auditor directs an other auditor to perform supervisory procedures with respect to a second other auditor on behalf of the lead auditor that should be addressed in AS 2101, for example, with respect to the qualifications of other auditors? What are the issues and what proposed requirements should be added to appendix B of AS 2101?

65. We note in our major points above our belief that the requirements do not sufficiently cover the types of multi-tiered structures used today.

Q39: Should certain of the proposed supervision procedures be required to be performed by individuals at the office issuing the auditor's report versus the firm issuing the auditor's report? If so, which procedures? Why should such required procedures be confined to individuals located at a particular office of the firm issuing the auditor's report?

66. We do not believe that it is necessary for any proposed supervision procedures to be required to be performed by individuals at the office issuing the auditor's report versus the firm issuing the auditor's report.

Q40: Do the proposed requirements provide sufficient emphasis on the need for two-way communication between the lead auditor and the other auditor throughout the audit? If not, what changes to the requirements are necessary to further promote such communication?

67. We note in our answer to question 26 above a specific example of proposed requirements that do not emphasize sufficiently the need for two-way communication between the lead auditor and the other auditor. We also note that extant ISA 600 probably needs to be updated in this respect.

A. Proposed Amendments to AS 1215 Related to Documentation of the Review of Documents Not Retained by the Office Issuing the Auditor's Report

V. Proposed Amendments to AS 1215

Q41: The proposed requirement in AS 1215.19A is designed to provide additional information about the review of working papers performed by the lead auditor. Is the proposed requirement appropriate and clear? Why or why not? What other information about the review of the working papers performed by the lead auditor would be appropriate?

68. Additional information about working papers reviewed but not obtained is an administrative issue and we struggle to understand how it will improve audit quality, as it will give no indication regarding substantive content, or the quality thereof.

Q42: The proposal does not require that the lead auditor make a list of all documents in the other auditor's files, including those not reviewed by the lead auditor. Should the lead auditor be required to document work papers in the other auditor's files that the lead auditor has not reviewed? Would such a requirement improve audit quality? What potential costs or unintended consequences, if any, would be associated with such a requirement? What practical difficulties would there be in complying with such a requirement?

69. The lead auditor should not be required to document work papers in the other auditor's files that the lead auditor has not reviewed.

Q43: In addition to the information currently in AS 1215.19, should the office issuing the auditor's report be required to obtain, review, and retain other important information supporting the other auditor's work, eg, (1) information about related parties or relationships or transactions with related parties previously undisclosed to the auditor or determined to be a significant risk; or (2) information about 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?

70. Requiring the retention of information relating to specific accounting areas is a dangerous precedent to set. Furthermore, while retaining information may always, in theory, aid the inspection process, we struggle to understand how retention will of itself, will improve audit quality. Auditor judgements regarding the significance of that information are more important.

Q44: In addition to the information currently in AS 1215.19g about all significant deficiencies and material weaknesses in internal control over financial reporting, should the office issuing the auditor's report be required to obtain, review, and retain information about all control deficiencies identified by other offices of the firm and other auditors?

71. While retaining information may aid the inspection process, we struggle to understand how, in isolation, retaining information about all control deficiencies identified by other offices of the firm and other auditors, will improve audit quality. Deficiencies identified by the other auditor may be completely inconsequential to the lead auditor and requiring such information to be communicated unnecessarily burdens the lead auditor. Auditor judgements regarding the significance of that information are more important

VI. Proposed Amendment to AS 1220

Q45: Should there be a requirement (as proposed) for the engagement quality reviewer to focus the reviewer's attention on the engagement partner's determination of the firm's sufficiency of participation in the audit?

72. The engagement quality control reviewer should not be required to re-perform the engagement partners' work in any specific respect. To require an evaluation of the engagement partner's determination of the sufficiency of participation is to set a dangerous precedent, as it is just one of many potential issues that the reviewer may wish to evaluate depending on the circumstances of the audit. In many cases, the extent of participation would be such that any such evaluation would be wasteful formality.

Q46: Are there any additional engagement quality review procedures that should be required for audits that involve 'other auditors' or 'referred-to auditors' (as proposed to be defined)?

73. There are no additional engagement quality review procedures that should be required for audits that involve other or referred-to auditors.

VII. Proposed New Standard for Audits that Involve Referred-to Auditors

We have not responded to the following questions as they arise from PCAOB inspections and/or are specific to the US.

Q47: Are the objectives of the proposed new standard clear and appropriate? If not, what changes are necessary?

Q48: Are the proposed requirements for performing procedures with respect to the audit of the referred-to auditor clear and appropriate? If not, what changes are necessary?

Q49: Are the conditions included in paragraph .06 of the proposed new standard clear and appropriate? Are there other conditions that should be met for the lead auditor to divide responsibility with a referred-to auditor?

Q50: Paragraph .07 of the proposed new standard describes the lead auditor's course of action in situations in which the lead auditor cannot divide responsibility. Are the requirements in this paragraph clear and appropriate? Why or why not? Are additional requirements necessary for such situations?

Q51: An unintended consequence of the Board's proposal, described earlier in this release, is the potential increase in the use of the divided responsibility model by auditors. Should the Board prohibit divided responsibility arrangements or impose further limitations on them, such as limiting them to equity method investees or situations in which the referred-to auditor covers only a small portion of the consolidated assets or operations? If so, what would be the costs and benefits of such a prohibition or limitation?

Q52: Are additional requirements, including supervisory requirements, necessary to describe responsibilities of the lead auditor in situations in which the lead auditor divides responsibility for the audit with another accounting firm? Are there any other situations that would present challenges with the application of the proposed requirements?

VIII. Other Considerations

A. Proposal to Supersede AI 10 (currently AU sec. 9543, *Part of Audit Performed by Other Independent Auditors: Auditing Interpretations of Section 543*), *Part of the Audit Performed by Other Independent Auditors: Auditing Interpretations of AS 1205*

Q53: Is superseding AI 10 appropriate, or is the interpretation necessary to fully describe the auditor's responsibilities under PCAOB standards?

We have not responded to this question as it arises from PCAOB inspections and/or is specific to the US.

B. Proposed Amendments Relating to Inquiries About Professional Reputation and Standing

Q54: Are the other proposed amendments relating to inquiries about professional reputation and standing of other auditors appropriate and clear in the context of each requirement? If not, what further amendments should the Board consider making to this requirement to improve its clarity?

We have not responded to this question as it arises from PCAOB inspections and/or is specific to the US.

IX. Additional Questions Regarding Certain Aspects of the Proposal

We have not responded to the following questions as they arise from PCAOB inspections and/or are specific to the US.

Q55: Are the proposed conforming amendments in Appendix 3 appropriate and clear? Why or why not? What changes to the amendments are necessary?

Q56: In addition to the proposed conforming amendments in Appendix 3, are other conforming amendments necessary in connection with the proposed changes to AS 1201, AS 1215, AS 1220, and AS 2101?

Q57: Paragraph .10d of AS 1301 (currently Auditing Standard No. 16), Communications with Audit Committees, describes requirements regarding the lead auditor's communication to the audit committee of certain information about the other auditors. Should the lead auditor's communication to the audit committee with respect to the lead auditor's or other auditors' responsibilities in an audit be more specific than is currently required? If so, what additional information should the lead auditor communicate?

Q58: Because the Board's proposal focuses on audit engagements, it does not include amendments for engagements other than audits. Should the proposal include changes for reviews of interim financial information under AS 4105, Reviews of Interim Financial Information (currently AU sec. 722, Interim Financial Information) that involve 'other auditors' or 'referred-to auditors' (as proposed to be defined)? If so, what additional changes are needed?

Q59: Is it sufficiently clear when AS 1201 (as proposed to be amended) or proposed AS 1206 – as opposed to AS 2503 – would apply to an audit of a company's equity method investment or other investments in an entity whose financial statements are audited by another accounting firm? If not, what change or guidance is needed?



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July 29, 2015

Ms. Phoebe W. Brown
Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: PCAOB 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, April 12, 2016) (PCAOB Rulemaking Docket Matter No. 042)

Dear Ms. Brown:

The U.S. Chamber of Commerce (the “Chamber”) is the world’s largest federation of businesses and associations, representing the interests of more than three million U.S. businesses and professional organizations of every size and in every economic sector. These members are both users and preparers of financial information. The Chamber created the Center for Capital Markets Competitiveness (“CCMC”) to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy. The CCMC believes that businesses must have a strong system of internal controls and recognizes the vital role external audits play in capital formation.

The CCMC supports efforts to improve audit quality and effectiveness and appreciates the opportunity to comment on the Public Company Accounting Oversight Board (“PCAOB”) *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Accounting Firm* (the “Proposal”).

The Proposal would supersede or amend various existing PCAOB auditing standards related to the lead auditor’s supervision of other auditors who are not part of the audit firm issuing the audit report (whether other independent accounting

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firms, including international network firms, or other individual accountants) and dividing responsibility for an audit with another accounting firm.

The CCMC has concerns about both the rationale for and approach of the Proposal, as well as the specifics regarding sufficiency determinations.

Discussion

Rationale

The Proposal intends to provide for a more risk-based supervisory approach and improve the integration of PCAOB auditing standards (such as those focused on risk, planning, and supervision) with the standard on supervision of audits involving other auditors. We agree that this seems a sensible updating of PCAOB auditing standards.

Another rationale for the Proposal is to incorporate into PCAOB auditing standards some “best practices” in the supervision of audits that involve other auditors, in particular by many of the larger audit firms that are part of international networks. In this regard, the Proposal intends to bring uniformity and consistency to the approaches used by all PCAOB registered firms.¹ We appreciate there may be potential benefits in doing so. Nonetheless, it raises concerns that the Proposal will impose different and greater costs on smaller audit firms, which require careful consideration by the PCAOB, including in its economic analysis.

Further, the Proposal intends to incorporate many of the concepts currently included in International Standard on Auditing (“ISA”) 600 on group audits promulgated by the International Auditing and Assurance Standards Board (“IAASB”). We applaud this thrust, as the CCMC has long advocated that the PCAOB should work with other standard setters, including the IAASB, on global convergence of auditing standards.

¹ For example, see the statement by Board Member Jay Hanson at the PCAOB open board meeting on April 12, 2016.

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However, the IAASB is currently considering ways to strengthen its standards on group audits.² Thus, even with this Proposal, the PCAOB's auditing standards related to supervision of other auditors should still consider similar work being done at the IAASB level (and vice-versa), including comments that are received on IAASB's consultation.

In addition, we recognize that the PCAOB is now implementing recommendations made by a consultant. However, we understand that these changes are focused on improving the PCAOB's internal process for and workflows in developing auditing standards. Thus, we would suggest more substantial and overarching changes need to be made in order for PCAOB audit standard setting to keep pace. In this regard, the CCMC strongly recommends the PCAOB develop a path for working with other standard setters to achieve global convergence of auditing standards.

Approach

The Proposal is premised on putting the onus on the lead auditor for all aspects related to supervision of other auditors. In this regard, the CCMC questions whether the Proposal strikes the right balance. Relatedly, we strongly recommend that the PCAOB's economic analysis rigorously assess the unintended consequences of the Proposal, including whether the Proposal inappropriately undermines the responsibilities of other auditors.

The CCMC recommends that the Proposal take a more holistic approach. To illustrate, the Proposal does not appear to sufficiently appreciate the role of other auditors' quality control systems (including network-wide audit methodologies and policies, as well as integrated independence, ethics, and training compliance functions), which are also inspected by the PCAOB. The Proposal also does not address, or risk-adjust the expectations where the other auditor is a member of the lead auditor's international network. For example, it would seem that the lead auditor should be able to place some reliance on the other audit firm's quality controls for independence, particularly if they are subject to both PCAOB and internal inspection

² For example, see the IAASB Invitation to Comment *Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits* (December 2015).

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July 29, 2016
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programs and comply with PCAOB quality control standards. In addition, the PCAOB has a project in process to revise the quality control standards. In turn, this raises a question about whether the Proposal should work in tandem with other PCAOB projects and, therefore, is premature at this time.

We also believe that the Proposal does not strike the right balance between the level and extent of supervision required here. A prescriptive approach may not lead to an efficient allocation of oversight. Instead, permitting an auditor to exercise professional judgment in determining the extent of supervision required would encourage greater consideration to areas and components that are more likely to contain risks of material misstatements.

Sufficiency Determination

Lastly, the CCMC is concerned about aspects of the Proposal involving sufficiency determinations, including the determination as to whether the firm can serve as lead auditor. For example, the Proposal states:

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 risks of material misstatement associated with the portion of the company's financial statements for which the engagement partner's firm performs audit procedures (which includes considering the portion's materiality), in comparison with the portions for which the other auditors perform audit procedures or the portions audited by the referred-to auditors.³

This requirement would be a substantial change in practice and, as proposed, seems vague. We question whether this aspect of the Proposal is workable or practicable. The CCMC is also concerned that it will result in determinations that run afoul of requirements for audit firm licensure and practice embedded in state laws.

³ See the Proposal, page A1-14.

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In conclusion, the CCMC appreciates the opportunity to comment on the Proposal. While we support efforts to improve audit effectiveness, we strongly urge the PCAOB to undertake a more holistic approach that incorporates the work of international standard setters and thoroughly analyzes economic costs from potentially unintended consequences.

The CCMC stands ready to assist in these efforts and would be happy to further discuss these matters.

Thank you for your consideration.

Sincerely,

A handwritten signature in black ink, appearing to read "Andres Gil". The signature is fluid and cursive, with a large initial "A" and a distinct "G".

Andres Gil



U.S. GOVERNMENT ACCOUNTABILITY OFFICE

441 G St. N.W.
Washington, DC 20548

July 29, 2016

Ms. Phoebe W. Brown
Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street NW
Washington, DC 20006-2803

PCAOB Rulemaking Docket Matter No. 042: PCAOB Release Number 2016-002: Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard - Dividing Responsibility for the Audit with Another Accounting Firm (April 2016)

Dear Ms. Brown:

This letter provides the U.S. Government Accountability Office's (GAO) responses to the Public Company Accounting Oversight Board's (PCAOB) release number 2016-002, *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard - Dividing Responsibility for the Audit with Another Accounting Firm*. GAO promulgates generally accepted government auditing standards, which provide professional standards for auditors of government entities in the United States.

As described in the proposal, the PCAOB seeks to strengthen the lead auditor's existing requirements and impose a more uniform approach to the lead auditor's supervision of other auditors. Such changes are intended to increase the lead auditor's involvement in and evaluation of the work of other auditors and thus improve the quality of audits, among other things.

In general, we believe the PCAOB's proposed changes to its standards related to the supervision of audits involving other auditors and dividing responsibility for an audit will improve audit quality. Our responses to the specific questions and related recommended revisions are included in the enclosure to this letter.

If you have questions about this letter or wish to discuss any of our responses, please feel free to contact me at (202) 512-3133 or dalkinj@gao.gov.

Sincerely yours,

A handwritten signature in black ink, appearing to read 'James R. Dalkin'.

James R. Dalkin
Director
Financial Management and Assurance

Enclosure

Enclosure: Responses to Questions

1. Does the description of existing audit practice accurately depict the state of practice? Does the discussion of the reasons to improve auditing standards sufficiently describe the nature of concerns arising from the use of other auditors that the Board should address? Are there additional concerns that the Board should seek to address?

We believe that it is appropriate for the Public Company Accounting Oversight Board (PCAOB) to consider ISA 600 (as well as the results of IAASB's post-implementation review) and the results of PCAOB's inspections. We are not aware of other issues that should be considered.

2. Are these proposed amendments to existing standards appropriate? Are additional changes needed to increase the likelihood that the lead auditor is sufficiently involved in the other auditor's work? Should the Board require specific procedures to address business, language, cultural, and other differences between lead auditors and other auditors, and if so, what types of procedures?

The proposed amendments to existing standards generally appear appropriate, except as noted in our responses below. We note that significant changes are achieved via appendix B to AS 2101 and appendix B to AS 1201. The PCAOB may consider whether it is more appropriate to include such audit requirements within the body of the corresponding standard, because it may appear to be of less importance if included as an appendix. Also, we have noted specific comments on certain proposed amendments in our responses to the questions below.

As to different business, language, cultural, and other differences between lead auditors and other auditors, the lead auditor needs to be able to effectively work with other auditors and review the other auditors' work given these differences. However, we do not believe that requiring specific procedures is necessary.

3. Are there any other areas of improvement in existing standards relating to audits that involve other auditors that the Board should address? Should the Board's standards be amended to address other responsibilities of the lead auditor? Are there related areas of practice for which additional or more specific requirements are needed, such as determining tolerable misstatement for the individual locations or business units under AS 2105?

We have not identified any other areas of improvement in existing standards relating to the auditor that involve other auditors that the PCAOB should address.

4. The Board requests comment generally on the baseline for evaluating the potential economic impacts of the proposal. Are there additional academic studies or data the Board should consider? The Board is particularly interested in studies or data that could be used to assess potential benefits and costs.

We are not providing comments related to this question.

5. The Board requests comment generally on the analysis of the need for the proposal. The Board is interested in any alternative economic approaches to analyzing the issues presented in this release, including references to relevant data, studies, or academic literature.

We are not providing comments related to this question.

6. The Board requests comment generally on the potential benefits to investors and the public. Are there additional benefits the Board should consider?

We are not aware of additional benefits that the PCAOB should consider.

7. The Board requests comment generally on the potential costs to auditors and companies they audit. Are there additional costs the Board should consider?

We are not providing comments related to this question.

8. The Board requests comment generally on the potential unintended consequences of the proposal. Are the responses to the potential unintended consequences discussed in the release adequate? Are there additional potential unintended consequences that the Board should consider? If so, what responses should be considered?

We are not providing comments related to this question.

9. Could the proposed requirement for lead auditor supervision diminish (or be perceived as diminishing) the other auditor's accountability for the work the other auditor performs? If so, are any changes to the proposal needed to describe the other auditor's responsibilities?

We concur with the PCAOB's proposed requirement for lead auditor supervision because ultimate accountability is with the lead auditor. We do not believe the proposal requires further clarification of the other auditor's responsibilities.

10. Could the proposed requirement for lead auditor supervision induce lead auditors in some audits to divide responsibility with another accounting firm rather than supervise the accounting firm? If so, how often might this division of responsibility occur?

In general, we believe the proposal for dividing responsibility is adequate and appropriately considers audit quality.

11. The Board requests comment generally on the alternative approaches that the Board considered but is not proposing, as described in this release. Are any of these approaches, or any other approaches, preferable to the approaches the Board is proposing? What reasons support those approaches over the approaches the Board is proposing?

We have consistently advocated for robust standards that are in harmony among the various standard setters. While the proposed approach generally should improve the quality of audits, we believe that the PCAOB should reconsider harmonizing the “other auditor” changes to better align with AU-C 600 and ISA 600.

12. Are there additional economic considerations associated with this proposal that the Board should consider? If so, what are those considerations?

We are not providing comments related to this question.

13. The Board requests comment generally on the analysis of the impacts of the proposal on EGCs. Are there reasons why the proposal should not apply to audits of EGCs? If so, what changes should be made so that the proposal would be appropriate for audits of EGCs? What impact would the proposal likely have on EGCs, and how would this affect efficiency, competition, and capital formation?

We are not providing comments related to this question.

14. The Board requests comment generally on the analysis of the impacts of the proposal on audits of brokers and dealers. Are there reasons why the proposal should not apply to audits of brokers and dealers? Are there any factors specifically related to audits of brokers and dealers that should affect the application of the proposal to those audits?

We believe that the proposed standard should be applied consistently for all PCAOB audits.

15. How much time following SEC approval would accounting firms need to implement the proposed requirements?

We are not providing comments related to this question.

16. Are the proposed definitions of: (a) “engagement team,” (b) “lead auditor,” (c) “other auditor,” and (d) “referred-to auditor” appropriate? Do the proposed definitions clearly describe individuals and entities that are included in these definitions? Is it clear which individuals or entities are not included in these definitions? If not, what changes to the proposed definitions are necessary?

The definitions proposed in the standards appear appropriate. However, we have consistently advocated for robust standards that are in harmony among the various standard setters, so the PCAOB should reconsider the use of terminology that harmonizes with AU-C 600 and ISA 600.

17. Some global network firms use short-term (several months) personnel sharing arrangements, during which some available personnel are seconded to other firms and function as their employees. Some firms contract with consulting firms or temporary workforce agencies for personnel that work alongside and in the same capacity as personnel on the engagement team that are employed by the lead auditor. Should these personnel be treated as part of the lead auditor?

To the extent that such personnel work under the direct supervision of the lead auditor, and such personnel comply with the corresponding requirements (e.g., independence, ethics, knowledge, skills, etc.), such personnel may be treated as part of the lead auditor.

18. Are there any situations in practice where applying the new definitions of “engagement team” and “other auditor,” including related requirements, would present practical challenges?

The applying of the new definitions of “engagement team” and “other auditor” may present challenges for firms who generally use AU-C 600 or ISA 600 as the definitions are not consistent. As noted in previous responses, we recommend that the PCAOB reconsider the use of terminology that harmonizes with AU-C 600 and ISA 600.

19. Should there be requirements for the lead auditor to: (1) specifically identify the engagement team members responsible for assisting the engagement partner of the lead auditor in fulfilling his or her supervisory responsibilities and (2) document such assignments? Should the individuals who assist the engagement partner with supervision be limited to engagement team members from the office issuing the auditor’s report?

A requirement can help the lead auditor to specifically identify and document the engagement team members responsible for assisting the engagement partner of the lead auditor in fulfilling his or her supervisory responsibilities, regardless of whether the individuals identified are part of the office issuing the auditor’s report.

20. To emphasize the importance of assigning the proposed planning and supervision requirements to personnel with the appropriate qualifications in audits involving other auditors, the proposed definition of “lead auditor” references existing standards that describe making appropriate assignments of engagement responsibilities. Does this reference appropriately address the responsibility to seek planning and supervision assistance from qualified engagement team members in these situations?

The references to existing standards appear to describe adequately the responsibility to seek planning and supervision assistance from qualified engagement team members.

21. The proposed requirements for determining whether a firm's participation is sufficient for it to serve as the lead auditor depend on the risks of material misstatement associated with the portion of the financial statements audited by the firm. (These requirements would apply regardless of whether the other auditor is from the same audit network as the lead auditor.) Should the Board consider alternative or additional criteria for determining whether a firm's participation is sufficient? For example, should the Board impose a quantitative threshold or specify criteria covering the locations of the company's principal assets, principal operations, or corporate offices? How would such criteria help address specific issues in practice?

Since the focus of the proposed requirement for determining whether a firm's participation is sufficient for it to serve as the lead auditor is based on the risks of material misstatement, it should be left to a firm to decide based upon a consideration of the relative risk of material misstatement. We do not believe that alternative or additional criteria are necessary for determining whether a firm's participation is sufficient.

22. What are the practical challenges with applying the proposed engagement partner's determination of the firm's sufficiency of participation in the audit? What changes, if any, should be made to address those challenges?

Challenges can still exist, particularly when the company is undergoing significant valuation changes via acquisition or significant growth in revenue, especially late in the period under audit. However, the engagement partner's determination of the firm's sufficiency of participation in the audit can be reconsidered during the audit to address the changes. This may result in changes in the lead auditor or adding a referred-to auditor. We do not believe changes are necessary to address these challenges.

23. Are there situations in practice in which the proposed sufficiency determination would cause changes in the firm serving as lead auditor? If so, what are these situations? What are the potential effects of those changes, including potential effects on costs and audit quality? What changes to the proposal, if any, would mitigate these issues?

As presented in our response to question 22, a company undergoing significant changes in valuation via acquisition or significant growth in revenue, especially late in the period under audit, may cause changes in the firm serving as lead auditor. The proposed changes, including adding a referred-to auditor, help to address these circumstances.

24. The proposed sufficiency determination would apply for audits in which the lead auditor supervises the work of other auditors and audits in which the lead auditor divides responsibility for the audit with another firm. Should there be

different requirements for the divided-responsibility scenario, for example, should there be additional criteria that require increased lead auditor participation in a divided responsibility scenario? If so, what should those requirements be?

We do not believe that there is a need for different requirements for the divided-responsibility scenario as it relates to the proposed lead auditor sufficiency determination.

25. Are the proposed requirements for the lead auditor to hold discussions with and obtain information from other auditors and referred-to auditors to identify and assess the risks of material misstatement appropriate and clear? Are there any practical challenges with this requirement? If so, what are they, and how could the proposed requirements be revised to address the challenges?

The proposed requirements for the lead auditor to hold discussions with and obtain information from other auditors and referred-to auditors to identify and assess the risks of material misstatement appear appropriate and clear.

26. Are the additional proposed requirements for the lead auditor when planning an audit that involves other auditors, which address independence and ethics, registration, and qualifications of and communications with other auditors, appropriate and clear? Are there requirements that should be added to or removed from Appendix B of AS 2101? If so, what are those requirements and why should they be included or excluded?

The additional proposed requirements for the lead auditor when planning an audit that involves other auditors—which address independence and ethics, registration, and qualifications of and communications with other auditors—appear appropriate and clear.

27. The proposed amendments require the lead auditor to gain an understanding of each other auditor’s knowledge of the SEC and PCAOB independence and ethics requirements and their experience in applying the requirements. Are there any additional costs or practical challenges associated with this? If so, what are they, and how could the proposed requirements be revised to mitigate these issues?

We are not providing comments related to this question.

28. Should the requirement for the lead auditor to gain an understanding of the knowledge, skill, and ability of the other auditors be limited to engagement team members who assist the lead auditor with planning and supervision?

The requirement appears narrow and does not ensure that the lead auditor fully understands the qualifications of the other auditors. The requirement should be broader to cover the other auditors participating in the work, not just those assisting with

planning and supervision. In addition, it is not clear how in a multitiered audit the lead auditor would gain an understanding of those assisting the lead auditor with planning and supervision at the different tiers.

29. Are the proposed requirements to determine that the lead auditor is able to communicate with the other auditors and gain access to their workpapers appropriate and clear? If not, what changes to the proposed requirements are necessary?

The proposed requirements to determine that the lead auditor is able to communicate with the other auditors and gain access to their workpapers appear appropriate and clear. However, see our responses to questions 34 and 35 for comments related to the communication with other auditors in a multitiered audit.

30. Are the proposed amendments to the requirements for determining the locations and business units at which audit procedures should be performed clear and appropriate?

The proposed amendments to the requirements for determining the locations and business units at which audit procedures should be performed appear to be clear and appropriate.

31. Are the proposed procedures to be performed by the lead auditor with respect to the supervision of the other auditor's work appropriate and clear? If not, how should the proposed requirements be revised?

The proposed procedures to be performed by the lead auditor with respect to the supervision of the other auditor's work appear appropriate and clear.

32. Currently, AS 1205.12 describes certain procedures that the lead auditor should consider performing when using the work of the other auditor (e.g., visiting the other auditor), which are not included in the proposal. Should the lead auditor be required to perform these or any other procedures? If so, what additional procedures should be required?

The PCAOB may consider clarifying that the proposed requirements do not preclude the lead auditor from performing additional procedures to ensure the quality of the other auditor's work. This would clarify that the lead auditor has flexibility to request or perform additional procedures (for example, visiting the other auditor).

33. Are the requirements for the written report from the other auditor sufficiently clear? Are these requirements appropriately scalable to the nature and significance of the work referred to the other auditor? Would the proposed requirement for the lead auditor to obtain a written report from the other auditor result in a significant change in practice? If so, what is the estimated economic impact (e.g., costs and benefits) of this change?

The requirements for the written report from the other auditor appear sufficiently clear, and the requirements appear appropriately scalable to the nature and significance of the work referred to by the other auditor.

34. Is the scalability of the proposed supervision amendments clear and appropriate? If not, what changes are necessary? Are the proposed requirements for situations in which the lead auditor directs an other auditor to perform supervisory procedures with respect to a second other auditor on behalf of the lead auditor clear? If not, how should the proposed requirements be revised?

We suggest the example in AS1201 paragraph .B3, explaining when the lead auditor directs one other auditor to perform supervisory procedures with respect to a second other auditor on behalf of the lead auditor, could be clarified to more clearly explain the supervisory procedures involving a multitiered audit.

35. In a multi-tiered audit where the lead auditor directs the first other auditor to perform certain procedures with respect to the second other auditor, is the proposed requirement that the lead auditor inform directly all other auditors of certain other specific matters appropriate? If not, how should the proposed requirements be revised?

The lead auditor directly informing all auditors appears appropriate. For instances where there is communication with a second other auditor, it may be useful for the lead auditor to inform the first other auditor of the nature and timing of the communication to the second other auditor.

36. In a multi-tiered audit, is the proposed requirement for the lead auditor to evaluate the first other auditor's supervision of the second other auditor's work clear? If not, how should the proposed requirements be revised?

The requirement for the lead auditor to evaluate the first other auditor's supervision of the second other auditor's work appears clear, but it may be helpful to include an example of how a lead auditor should address deficiencies in the first other auditor's supervision of the second other auditor. In the multitier example, the PCAOB may consider reemphasizing the lead auditor's responsibility for all the work, independent of whether the lead auditor depends on the other auditor's supervision of other tier auditors.

37. Do the proposed requirements sufficiently cover the types of multi-tiered structures used today? If not, what other multi-tiered structures are used and what changes are needed to appropriately cover those situations?

We are not providing comments related to this question.

38. Do issues exist when the lead auditor directs an other auditor to perform supervisory procedures with respect to a second other auditor on behalf of the lead auditor that should be addressed in AS 2101, for example, with respect to the qualifications of other auditors? What are the issues and what proposed requirements should be added to appendix B of AS 2101?

We are not providing comments related to this question.

39. Should certain of the proposed supervision procedures be required to be performed by individuals at the office issuing the auditor's report versus the firm issuing the auditor's report? If so, which procedures? Why should such required procedures be confined to individuals located at a particular office of the firm issuing the auditor's report?

Given the nature of electronic workpapers and virtual communication, we question the need to require review by individuals at a particular office, assuming they are appropriately supervised.

40. Do the proposed requirements provide sufficient emphasis on the need for two-way communication between the lead auditor and the other auditor throughout the audit? If not, what changes to the requirements are necessary to further promote such communication?

The proposed requirements are generally adequate. However, the communication requirements in multitiered structures may be improved if the PCAOB adds clarity to ensure there is adequate communication among all tiers.

41. The proposed requirement in AS 1215.19A is designed to provide additional information about the review of working papers performed by the lead auditor. Is the proposed requirement appropriate and clear? Why or why not? What other information about the review of the working papers performed by the lead auditor would be appropriate?

The proposed requirement in AS 1215.19A provides additional information about the review of workpapers performed by the lead auditor, but the proposed requirement could be improved by including the purpose for the review of the workpapers.

42. The proposal does not require that the lead auditor make a list of all documents in the other auditor's files, including those not reviewed by the lead auditor. Should the lead auditor be required to document work papers in the other auditor's files that the lead auditor has not reviewed? Would such a requirement improve audit quality? What potential costs or unintended consequences, if any, would be associated with such a requirement? What practical difficulties would there be in complying with such a requirement?

A requirement that the lead auditor list all documents in the other auditor's files would be onerous, and it is unclear that it would improve audit quality. As noted below, we believe that the lead auditor should document important information supporting the other auditor's work. Another alternative would be for the other auditor to list the documents it has prepared throughout the audit and make the list available to the lead auditor. This way, the lead auditor would be able to determine which of the documents the other auditor has prepared that should also be reviewed by the lead auditor.

43. In addition to the information currently in AS 1215.19, should the office issuing the auditor's report be required to obtain, review, and retain other important information supporting the other auditor's work, e.g., (1) information about related parties or relationships or transactions with related parties previously undisclosed to the auditor or determined to be a significant risk; or (2) information about 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?

We would support the PCAOB requiring the office issuing the auditor's report to obtain, review, and retain other important information supporting the other auditor's work. This could include his or her consideration of the other auditor's files and include appropriate information on key areas and/or documents reviewed and significant judgments made by the other auditor and the supporting rationale. For example, information about significant transactions that are outside the normal course of business for the company or that otherwise appear to be unusual because of their timing, size, or nature. The PCAOB may also consider adding a requirement for the other auditor to communicate any other matters that may be relevant to the lead auditor or that the other auditor wishes to draw to the attention of the lead auditor.

44. In addition to the information currently in AS 1215.19g about all significant deficiencies and material weaknesses in internal control over financial reporting, should the office issuing the auditor's report be required to obtain, review, and retain information about all control deficiencies identified by other offices of the firm and other auditors?

As noted in our response to question 43, we would support the PCAOB requiring the lead auditor's consideration of the other auditor's files and include appropriate information on key areas and/or documents reviewed and significant judgments made by the other auditor and the supporting rationale. This could include other matters that may be relevant to the lead auditor, such as areas of higher risks and information on additional control deficiencies, or that the other auditor wishes to draw to the attention of the lead auditor.

45. Should there be a requirement (as proposed) for the engagement quality reviewer to focus the reviewer's attention on the engagement partner's determination of the firm's sufficiency of participation in the audit?

We concur with the proposed requirement that the engagement quality reviewer review the engagement partner's determination of the firm's sufficiency of participation in the audit.

46. Are there any additional engagement quality review procedures that should be required for audits that involve "other auditors" or "referred-to auditors" (as proposed to be defined)?

We believe the additional requirements are sufficient.

47. Are the objectives of the proposed new standard clear and appropriate? If not, what changes are necessary?

The objectives of the proposed new standard appear clear and appropriate.

48. Are the proposed requirements for performing procedures with respect to the audit of the referred-to auditor clear and appropriate? If not, what changes are necessary?

The proposed requirements for performing procedures with respect to the audit of the referred-to auditor appear clear and appropriate.

49. Are the conditions included in paragraph .06 of the proposed new standard clear and appropriate? Are there other conditions that should be met for the lead auditor to divide responsibility with a referred-to auditor?

Paragraph .06 of the proposed AS 1206 appears clear and appropriate.

50. Paragraph .07 of the proposed new standard describes the lead auditor's course of action in situations in which the lead auditor cannot divide responsibility. Are the requirements in this paragraph clear and appropriate? Why or why not? Are additional requirements necessary for such situations?

We believe that paragraph .07 should be revised to focus on issuing the report without dividing responsibilities, and if not feasible, refer the auditor to AS 3101 (currently AU sec. 508), *Reports on Audited Financial Statements*. For example, paragraph .07 could be reworded as follows:

.07 In situations in which the lead auditor is unable to divide responsibility with another accounting firm (e.g., due to concerns about the competence or independence of the referred-to auditor), the lead auditor should consider planning and performing procedures with respect to the relevant business unit that are necessary for the lead auditor to issue an opinion on the company's financial statements and, if applicable, internal control over financial reporting without dividing responsibility. If that is not feasible, the auditor should consider the effect of the scope limitation in accordance with AS 3101.

51. An unintended consequence of the Board's proposal, described earlier in this release, is the potential increase in the use of the divided responsibility model by auditors. Should the Board prohibit divided responsibility arrangements or impose further limitations on them, such as limiting them to equity method investees or situations in which the referred-to auditor covers only a small portion of the consolidated assets or operations? If so, what would be the costs and benefits of such a prohibition or limitation?

The PCAOB should monitor the changes once they take effect and determine if there is an increase in the use of the divided responsibility model by auditors and its impact, if any, on audit quality. Limiting auditors' use of the divided responsibility model may cause unintended consequences in audits.

52. Are additional requirements, including supervisory requirements, necessary to describe responsibilities of the lead auditor in situations in which the lead auditor divides responsibility for the audit with another accounting firm? Are there any other situations that would present challenges with the application of the proposed requirements?

We do not believe additional requirements are necessary to describe the responsibilities of the lead auditor in situations in which the lead auditor divides responsibility for the audit with another accounting firm.

53. Is superseding AI 10 appropriate, or is the interpretation necessary to fully describe the auditor's responsibilities under PCAOB standards?

Superseding AI 10 appears appropriate, as the PCAOB is proposing to supersede AS 1205.

54. Are the other proposed amendments relating to inquiries about professional reputation and standing of other auditors appropriate and clear in the context of each requirement? If not, what further amendments should the Board consider making to this requirement to improve its clarity?

The other proposed amendments relating to inquiries about professional reputation and standing of other auditors appear appropriate and clear in the context of each requirement.

55. Are the proposed conforming amendments in Appendix 3 appropriate and clear? Why or why not? What changes to the amendments are necessary?

The proposed conforming amendments in appendix 3 of the proposal appear appropriate and clear.

56. In addition to the proposed conforming amendments in Appendix 3, are other conforming amendments necessary in connection with the proposed changes to AS 1201, AS 1215, AS 1220, and AS 2101?

We did not identify any other conforming amendments necessary in connection with the proposed changes to AS 1201, AS 1215, AS 1220, and AS 2101.

57. Paragraph .10d of AS 1301 (currently Auditing Standard No. 16), *Communications with Audit Committees*, describes requirements regarding the lead auditor’s communication to the audit committee of certain information about the other auditors. Should the lead auditor’s communication to the audit committee with respect to the lead auditor’s or other auditors’ responsibilities in an audit be more specific than is currently required? If so, what additional information should the lead auditor communicate?

We do not believe that the lead auditor’s communication to the audit committee with respect to the lead auditor’s or other auditors’ audit responsibilities should be more specific than is currently required.

58. Because the Board’s proposal focuses on audit engagements, it does not include amendments for engagements other than audits. Should the proposal include changes for reviews of interim financial information under AS 4105, *Reviews of Interim Financial Information* (currently AU sec. 722, *Interim Financial Information*) that involve “other auditors” or “referred-to auditors” (as proposed to be defined)? If so, what additional changes are needed?

The proposal should include changes for reviews of interim financial information under AS 4105, *Reviews of Interim Financial Information* (currently AU sec. 722, *Interim Financial Information*), that involve “other auditors” or “referred-to auditors.”

59. Is it sufficiently clear when AS 1201 (as proposed to be amended) or proposed AS 1206—as opposed to AS 2503—would apply to an audit of a company’s equity method investment or other investments in an entity whose financial statements are audited by another accounting firm? If not, what change or guidance is needed?

We are not providing comments related to this question.



July 29, 2016

Office of the Secretary, PCAOB
1666 K Street, NW
Washington, DC 20006-2803

Dear Board Members:

The Virginia Society of CPAs (VSCPA) Accounting & Auditing Advisory Committee has reviewed the following documents issued by the Public Company Accounting Oversight Board (PCAOB):

- PCAOB Release No. 2016-002, April 12, 2016
Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors, and
- PCAOB Rulemaking Docket Matter No. 042 Proposed Auditing Standard — Dividing Responsibility for the Audit with Another Accounting Firm.
(Collectively referred to herein as Release)

The VSCPA is a leading professional association dedicated to enhancing the success of all CPAs and their profession by communicating information and vision, promoting professionalism, and advocating members' interests. VSCPA membership consists of more than 12,000 individual members who actively work in public accounting, private industry, government and education. We appreciate the work the PCAOB has undertaken on this effort and the opportunity to respond to this Release.

Overall, we agree with the requirements of the Release. We have attached detailed responses to the questions posed by the PCAOB. We also believe the amendments will improve the quality of audits in these circumstances and align the applicable requirements with the PCAOB's risk-based, supervisory standards.

The VSCPA appreciates the opportunity to respond to this Release. Please direct any questions or concerns to VSCPA Vice President, Advocacy Emily Walker, CAE, at ewalker@vscpa.com or (804) 612-9428.

Sincerely,

A handwritten signature in black ink that reads "Charles M. Valadez".

Charles M. Valadez, CPA, CGMA, CITP
Chair
2016–2017 VSCPA Accounting & Auditing Advisory Committee
Charles Valadez, CPA — Chair
Joshua Keene, CPA — Vice Chair
Zachary Borgerding, CPA
Michael Cahill, CPA
Tamara Greear, CPA
M. James Hartson, Jr., CPA
Ashleigh Smith, CPA
Kulthida Strey, CPA
Forrest Wagoner, II, CPA
Mulugeta Wondimu, CPA

Response to PCAOB Release No. 2016-002, April 12, 2016
Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors, and
Proposed Auditing Standards
Dividing Responsibility for the Audit with Another Accounting Firm

Question Responses:

1. Yes, the description of existing audit practice accurately depicts the state of practice. Evaluations indicating that there have been identified deficiencies in audits attributable to the guidance, or lack thereof, provided in the standards as currently written, are sufficient reason to improve the standards related to the use of other auditors.
2. Yes, the proposed amendments to existing standards are appropriate, specifically the proposals to supersede AS 1205 in the area of work and reports of other auditors by requiring risk-based auditing supervision as under AS 1201. Additionally, proposing revisions to the requirement on representation of licensing both under applicable jurisdiction as well as pursuant to rules of PCAOB is essential, as not all firms are “created equal”, and the present standards allow too much ambiguity in the requirements of the lead auditor in relation to the other auditors. The Board should further develop specific procedures or guidance to address language, cultural and other differences between lead auditors and other auditors — for example, specific communication requirements and required understanding of specific audit procedures that would be standard to the nature and scope of the majority of audits.
3. While the proposed amendments appear to address a variety of the areas that are deficient and even too broad for consistent application, adding requirements for determining/applying tolerable misstatement for locations or units at the direction of the lead auditor would add to the overall efficiency and consistency of reporting and subsequently incorporating the multiple sources of information to the final cumulative report.
4. The Board’s discussion does indicate that due to the more recent nature of the standards, limited baseline data exists for evaluating the potential economic impact of the proposal. Until more incidents with direct financial impact occur, there are only limited sources to use in assessing the cost/benefit analysis.
5. The Board has provided a detailed discussion of the need for the proposal as well as the potential positive and negative aspects to additional requirements on lead auditors. There are always costs to change; it is early to determine the exact nature of the proposed changes. However, we agree that the many firms that have already taken the initiative to add a methodology that improves their own procedures in lieu of actual existing requirements will be least impacted, while other firms may have limited negative issues with a risk-based approach, as some less complex scenarios will not warrant a great deal of added cost.
6. Auditors and the accounting profession in general are viewed as the “gatekeepers” of the financial world, whether or not the depiction is an appropriate burden or not. As such, implementing the proposed changes should decrease the overall likelihood of misstatement by enhancing the verification process of information relied upon by other auditors, and therefore should serve as added safeguards for the investors and general public through their ability to rely on the financial statement data and related disclosures.
7. Added costs generally with more standards and requirements, comes both to the auditors as well as the companies they audit. In this particular situation, however, auditors should already be performing the essence of the proposed changes, and hopefully adding further specifications will result in manageable changes to overall costs.
8. The Board’s evaluation of the potential unintended consequences of the proposal seems adequate. We would not add any additional responses at this time.
9. The proposal does not diminish the other auditor’s accountability for the work performed. If the new standards are applied correctly, the lead auditor’s supervision should hold the other auditors to a higher level of overall accountability, thus accomplishing the primary purpose of making such changes.

10. While there is always a possibility that lead auditors could shift to a divided-responsibility scenario, based on current data, the likelihood appears minimal.
11. In evaluating alternative approaches to changes, the Board appears to have reached logical conclusions that serve the intent of the proposed amendments without thwarting the outcome by making the process burdensome or overly tedious. In general, the approach the Board is proposing appears sound. We do not recommend a different approach.
12. There are always alternatives to be considered in every situation, but the Board has made a thorough analysis of the economic impact of the proposal. The only added thought to consider is perhaps some type of added risk-based analysis developed in correlation to entity size that would provide a streamlined set of procedures for smaller companies.
13. The proposal should apply to EGCs primarily for the enhanced risk associated with their size and unknown elements that are inherent in the nature of their existence. While it is not in any entity's interest to create standards that deter them from being competitive, the risks associated with the methods of competition are those at the heart of many audit requirements. Therefore, in order to be considered a good risk to investors, their standards should be as high as their competitors.
14. The proposal should apply to audits of brokers and dealers in order to enhance the reliability of financial data between management and the customer.
15. Since the essence of the standards substantially exists in practice, implementing proposed amendments should not be as time consuming. One year following the end of the year of issuance should be sufficient.
16. The definitions appear appropriate and clear.
17. Although temporary and contracted personnel should be evaluated for the appropriate skill, knowledge, and experience of the assigned tasks, they should not necessarily be the same as the lead auditor.
18. We cannot identify any circumstances.
19. There should be workpaper documentation of the engagement team members responsible for assisting the engagement partner in the supervisory duties. It is not a necessity for the individuals assisting in the supervision to be from the office issuing the report as long as adequate documentation of the team is maintained in the workpapers. Current technology provides the capability of multi-office supervision with proper standards and documentation.
20. We agree that the definition "lead auditor" appropriately addresses the planning and supervision requirements as detailed.
21. Using the risk of material misstatement associated with financial statements audited by the firm is sufficient for the evaluation of the lead auditor role. Applying alternative quantitative criteria is too broad from entity to entity and could potentially lead to unintended or unfavorable outcomes.
22. Sufficient communication and evaluation of materiality by location or unit, while incorporating the whole for a full understanding of the firm's participation, is the challenge in general.
23. The proposed sufficiency determination is well designed to evaluate the firm serving as lead auditor, but there is always an unknown situation that can arise in practice. For situations of an unusual and infrequent nature, perhaps additional quantitative elements could be evaluated to ensure the accuracy of the determination.
24. If applied consistently, the proposed sufficiency determination should be effective in the divided responsibility scenario as well.
25. Communication is crucial to the process between lead and other auditors, especially in the evaluation of risk. Therefore, the proposed requirements are appropriate and clear. In the current age of technology, communication barriers should be easily addressed even in the most challenging of situations, but should not be an impediment to accomplishing the overall goal.
26. Yes, the requirements on independence and ethics, registration, qualifications of, and communication are clear.
27. Since firms are subject to various oversight and licensing requirements, obtaining the experience and qualification of the other auditor should not be a costly process, but something easily provided in most cases.
28. Team leaders and firm qualifications should be sufficient for the SKE evaluation.
29. Yes, the requirements for communication and access are clear.
30. Yes, the requirements for determining location and business unit are clear and appropriate.

31. Yes, the proposed procedures to be performed by the lead auditor with respect to supervision of the other auditor's work are appropriate and clear.
32. The procedures under AS 1205.12 that indicate they should be considered, but are not included in the proposal. The consideration of the procedures should be documented and indicated as to why performed or not, but the actual performance should be based on the professional judgment of the lead auditor, as those procedures that become necessary under these provisions vary by specific audit situation and should not be required in every case.
33. Yes, the written report requirements are clear and appear appropriately scalable to the nature and significance of the work referred to the other auditor.
34. Yes, the scalability of the proposed supervision amendment is clear and appropriate, and the proposed requirements for the lead auditor to direct the other auditor to perform supervisory procedures are also clear.
35. Yes, as complex as multi-tiered scenarios can become, the procedures for the lead auditor to direct the first other auditor to perform certain procedures with respect to the second other auditor are appropriate within the guidance.
36. Yes, the proposed requirement for the lead auditor to evaluate the first other auditor's supervision of the second other auditor in a multi-tiered audit are clear.
37. The proposed requirements appear to sufficiently cover the types of multi-tiered structures used today.
38. A clear line of communication from lead auditor to first auditor and then second auditor respectively should be established and documented to prevent any misinterpretation of the responsibilities at each level.
39. As long as a documented trail of procedures performed with indication of responsibility and why by particular office, it should not be necessary for the issuing office as opposed to the issuing firm to do any specific set of procedures in all audits.
40. Yes, the proposed requirements provide sufficient emphasis on the need for two-way communication between lead auditor and the other auditor throughout the audit.
41. Yes, the proposed requirement for review of working papers by the lead auditor is appropriate and clear.
42. While omissions of items contained in workpapers, whether reviewed or not, could be misleading, the lead auditor should review the areas significant to the material presentation and conclusions in the financial statements. The detailed list of those items reviewed would be a sufficient indicator of the process. Requiring a listing of all documents in the other auditor's files, specifically those not reviewed by the lead auditor, seems cumbersome, costly from a time perspective, and very impractical from a pure documentation viewpoint.
43. Yes, in most cases the office issuing the auditor's report should be required to obtain, review, and retain documentation on areas of significant risk or transaction class.
44. Yes, the office issuing the auditor's report should be required to obtain, review and retain information about all control deficiencies identified by other offices. They should also follow up in subsequent years as to corrective actions, if any, in the risk determination process.
45. Yes, there should be a requirement for the engagement quality reviewer to review the engagement partner's determination of the firm's sufficiency of participation in the audit.
46. The quality review should perhaps include a review of the engagement partner's evaluation of the other auditors licensing/qualifications as part of the documentation process.
47. Yes, the objectives of the proposed new standard are clear and appropriate.
48. Yes.
49. Yes.
50. Yes.
51. The Board should not necessarily prohibit divided responsibility arrangements, but further evaluation of potential imposed limitations should be explored before a final determination on procedures is completed.
52. No, not additional requirements are recommended at this time.
53. We are not necessarily in agreement with superseding AI 10 as the interpretation provides useful information to describe the auditor's responsibilities.
54. Yes, it is appropriate and clear.

55. Yes, it is clear.
56. No further conforming amendments are recommended at this time.
57. In our opinion, the lead auditor's communication with the audit committee is very important, but adding further information would possibly lead to confusion rather than clarity.
58. If reviews are to include the work of other auditors and have an implication of reliance by the lead, then the proposal should apply to them.



Exhibit 2(a)(D)

Alphabetical List of Commenters on the Proposal in PCAOB Release No. 2017-005	
1	American Accounting Association
2	Chris Barnard
3	BDO USA, LLP
4	California Society of Certified Public Accountants
5	California State Teachers' Retirement System
6	Center for Audit Quality (2 Letters)
7	Crowe Horwath LLP
8	Deloitte & Touche LLP
9	Ernst & Young LLP
10	Florida Institute of Certified Public Accountants
11	Grant Thornton LLP
12	Illinois CPA Society
13	Institut der Wirtschaftsprüfer (IDW)
14	KPMG LLP
15	Professor Joseph A. Maffia
16	New York State Society of Certified Public Accountants
17	Piercy Bowler Taylor & Kern
18	PricewaterhouseCoopers LLP
19	RSM US LLP
20	The Institute of Chartered Accountants in England and Wales (ICAEW)
21	U.S. Chamber of Commerce, Center for Capital Markets Competitiveness

November 15, 2017

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D. C. 20006-2803

Via email to comments@pcaobus.org

Dear Board Members:

The Auditing Standards Committee of the Auditing Section of the American Accounting Association is pleased to provide comments on the PCAOB Rulemaking Docket Matter No. 042; PCAOB Release No. 2017-005, Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Accounting Firm.

The views expressed in this letter are those of the members of the Auditing Standards Committee and do not reflect an official position of the American Accounting Association. In addition, the comments reflect the consensus view of the Committee, not necessarily the views of every individual member.

We hope that our attached comments and suggestions are helpful and will assist the Board. If the Board has any questions about our input, please feel free to contact our committee chair for any follow-up.

Respectfully submitted,

Auditing Standards Committee
Auditing Section – American Accounting Association

Contributors:

Sean Dennis, University of Kentucky
Denise Dickins, East Carolina University
Christine Earley, Providence College
Christine Nolder, Suffolk University
Chair – Tammie Schaefer, University of Missouri-Kansas City, (816) 235-2311,
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Responses to Selected Questions in the Supplemental Request for Comment

Question 1. *Is the revised requirement for determining the sufficiency of participation to serve as lead auditor, based on risk and importance of the locations, appropriate and clear?*

The word “importance” in paragraph .B2.b creates some ambiguity. Scoping of audit work at locations is based on “significance” of the location, which is usually linked to materiality. The use of the word “importance” of locations in this case does not link to either concept – significance or materiality. It appears that auditors should interpret this word in a similar manner to the way they would interpret based on “materiality” We encourage the Board to further clarify how auditors should interpret this word choice. For example, should “importance” imply a user perspective in the same way that “materiality” would?

The word “importance” may also be construed as less precise than the word “materiality.” While there is relatively little research on the effects of the auditing standard precision, several studies find that accounting standard precision influences the way jurors evaluate auditor negligence. Namely, jurors experience more difficulty determining the extent to which an accounting treatment conforms to imprecise standards, as compared to precise standards; as a result, jurors are relatively less able to use compliance with imprecise accounting standards to evaluate audit quality (e.g., Gimbar, Hansen, and Ozlanski 2016; Kadous and Mercer 2016). We, therefore, encourage the Board to consider whether using relatively less precise wording (i.e., “importance” versus “materiality”) may have unintended effects on the way stakeholders evaluate audit quality. In addition to improving the clarity of .B2.b, more precise wording here would also be more consistent with wording used in other standards.

Question 2. *Is the additional sufficiency threshold for divided responsibility engagements clear? Should this be a bright-line requirement, or does this threshold need to allow for exceptional situations? Are there any other implications of this threshold that the Board should consider, such as investor protection implications or auditing challenges related to the revised requirement?*

The threshold requirement proposed to be added to paragraph .B2 is an improvement. As noted in the discussion of this modification (p. 10, 11 of Release No. 2017-005), while the “50 percent” threshold has been a standard historically applied in practice, qualitative considerations should also influence the determination of “sufficiency of participation.”

To aid in the auditor’s evaluation of “sufficiency,” the Board should consider including examples where it might be appropriate for an auditor to serve as lead-auditor even when auditing less than 50 percent of an issuer (e.g., significant late-year acquisitions or other unanticipated events or conditions that increase the portion of assets or revenue audited by other auditors beyond the 50 percent threshold – p.11 of Release No. 2017-005), as well as when it might not be appropriate for a lead auditor to rely on other auditors even though a component represents less than 50 percent of an issuer’s assets and revenues (e.g., a component representing 49 percent of assets or revenues, and more than 50 percent of cash

flows). Given the potential for acceptable situations outside of the 50 percent threshold, it seems appropriate to allow for exceptional situations rather than implementing a bright-line requirement.

As it appears the Board's intention is to require justification for reliance on other auditors in cases where a component's assets or revenues exceed 50 percent of a company's consolidated assets and revenues (p. 10 of Release No. 2017-005), it would be helpful to state that requirement in paragraph .B2.

Question 3. *Are the revised requirements relating to the other auditors' compliance with the independence and ethics requirements appropriate? Are there any practical challenges associated with the revised amendments? If so, what are they, and how could the proposed requirements be revised to address the challenges?*

The revised requirements relating to the independence of other auditors seem clear. However, such requirements could be enhanced by providing practical examples. In particular, paragraph .B4.a could be amended to include the following wording from the release: "For example, the lead auditor may obtain a written description of the other auditor's process and results of the process, or may obtain this understanding through inquiry, and perform follow-up procedures as necessary to address gaps in the process or indications of potential noncompliance" (p. 13 of Release 2017-005).

Because the "auditor's processes for determining compliance with the SEC independence requirements and PCAOB independence and ethics requirements" (paragraph .B4.a) are part of each audit firm's quality control (QC) program (Bedard, Deis, Curtis and Jenkins 2008; Church, Jenkins, McCracken, Roush and Stanley 2015), and firms' QC programs are regularly inspected by the PCAOB, information about the independence process at the other auditor's firm should be readily available to the lead auditor.

For some smaller auditors that may currently lack formalized and/or documented procedures for assessing and addressing independence, the importance of independence and its influence on audit quality (Tepalagul and Lin 2014) merits the possible imposition of additional costs associated with the proposed modifications. However, as noted on p. 14 of the Release, although the Board has decided not to allow "reliance" on a network in determining the other auditor's compliance with independence ethics requirements, research has shown that membership in networks has been associated with higher levels of audit quality for smaller firms (Bills, Cunningham, and Myers 2016). Therefore, the Board may consider allowing membership in a network to be a factor that reduces risk associated with independence for firms that may not have a robust independence and ethics process of their own. In other words, membership in a network would not substitute for the lead auditor's obtaining an understanding of the other firm's independence and ethics processes, but a strong independence process at the network level that is adhered to by the local level firm could be one factor that helps address a gap in or lack of documented processes at the local firm level.

Question 4. *Are the proposed amendments relating to the knowledge, skill, and ability of the other auditor, revised by this release, appropriate? Are there any practical challenges associated with the revised amendments? If so, what are they, and how could the proposed requirements be modified to address the challenges?*

A lead auditor's assessment of the knowledge, skill, and ability of auditors assigned to component audits is important and the proposed modifications seem clear. The knowledge level of each individual assigned to the engagement team is difficult to assess, so a focus on the firm-level processes for disseminating knowledge throughout the firm is appropriate, as firms have multiple knowledge sharing avenues to ensure that auditors can access the resources they need to conduct the audit (Bedard et al 2008; Vera- Muñoz, Ho and Chow 2006; Carson 2009). The standard as amended (.B6.a and .B6.b) focuses heavily on ensuring that the lead auditor has assessed whether engagement team members in the other auditor's firm have received proper training and that the other audit firm itself has the proper industry expertise, but there is no mention of other resources that can enhance an individual auditor's knowledge, such as the ability to consult with other experts in the firm about matters that are highly complex. As noted in research on quality control and firm networks (Bedard et al. 2008; Bills et al. 2016), the presence of consultation units and electronic decision aids are two such resources that can help enhance audit quality within firms and engagements by giving engagement auditors direct access to firm-level expertise. It may therefore be appropriate to include some mention of the lead auditor's assessment of the presence of these resources in the standard in addition to assessment of training. Also, in the Release on p. 15, the Board notes that some commenters suggested relying on the network's system of quality control when the other auditor and lead auditor are in a common network. Although, the lead auditor must still assess the training and industry expertise of the other auditor within the network, knowledge of the network's processes for consultation and provision of other knowledge sharing resources could aid the lead auditor in assessing the knowledge, skill, and ability of the other auditor.

Additionally, some examples may be helpful in guiding the lead auditor in understanding this section of the standard. For example, paragraph .B6.b could be enhanced by adding the following wording from the Release: "Possible sources of information that are relevant to the lead auditor's understanding of the knowledge, skill, and ability of relevant personnel include the lead auditor's own experience working with them, the other auditor's policies regarding the nature, scope, and timeliness of relevant training for them, information about internal inspection results regarding them, and publicly disclosed disciplinary action by regulators against them" (p. 16 of Release 2017-005).

Question 5a. *Are the proposed new additions to AS 1015 (Due Professional Care) and revision to AS 1201 (Supervision) relating to the other auditors' responsibility appropriate and clear?*

The proposed modifications seem clear and address commenters' requests for an explicit reference to other auditors' responsibilities (AS 1015) and guidance regarding what should be in the other auditors' written report (AS 1201).

Question 5b. *Is it clear that AS 1015 Due Professional Care already applies to referred-to auditors that perform audits under PCAOB standards?*

Yes, it is clear that AS 1015 applies to referred-to auditors that perform audits under PCAOB standards.

Question 6. *Are the proposed new additions to AS 2101.B2 appropriate and clear? Also, is it clear that the necessary level of detail of the other auditor's audit documentation that the lead auditor obtains and the necessary extent of the lead auditor's review according to requirements in proposed Appendix B of AS 1201 are scalable based on the factors in the existing standard regarding the necessary extent of supervision?*

The proposed new additions to the standard seem appropriate and clear, and the scalable nature of the documentation to be provided for review is clearly stated in the standard. As written, the standard indicates that the other auditor would prepare documentation for review, the lead auditor would review the documentation, and draw conclusions based on this review. If the documentation indicates that sufficient appropriate evidence has not been obtained, the standard recommends that the lead auditor consider whether additional evidence should be obtained. However, it seems that waiting until the final summary memo is prepared to make this determination may result in an inefficient audit. Research has demonstrated that one challenge to group audits is lack of clear communication between the lead auditor and other auditors (Downey and Bedard 2016), and knowledge sharing within geographically-dispersed teams can be negatively affected by cultural differences, particularly in how teams challenge the lead auditor, or even ask questions of the lead auditor (Vera-Muñoz et al. 2006; Downey and Bedard 2016). One solution proposed by Downey and Bedard (2016) is to ensure frequent communication between the group auditor (lead auditor) and component auditor (other auditor) throughout the engagement. The proposed standard should acknowledge the complex and iterative nature of this process and provide additional guidance in terms of frequency of communication and the iterative nature of the documentation.

Additionally, although on p. 20 of the Release it states that the proposed amendments to the standard would cover “Obtaining and reviewing the other auditor’s description of the nature, timing and extent of its audit procedures,” the words “nature, timing, and extent” are struck from the actual standard paragraph .B2b. It is unclear why these words are struck from the standard given the goal stated in the Release.

Question 7. *Are the revised proposed requirements for situations in which the lead auditor directs an other auditor to perform supervisory procedures with respect to a second other auditor on behalf of the lead auditor clear? If not, how should the revised proposed requirements be revised?*

The proposed requirements with respect to multi-tiered engagement team structures in the standard (paragraph .B3) seem clear in terms of specifying that the lead auditor can delegate certain tasks outlined in paragraph .B2. Research has not specifically addressed the multi-

tiered nature of group audit engagements, but Downey and Bedard (2016) does note that efforts taken to reduce the complexity of these engagements can have positive impacts on how group audits are conducted. Therefore, it seems that in certain circumstances, having the first other auditor oversee the second other auditor has the potential to improve communication and oversight, and ultimately, as a result, improve the outcome of the engagement.

Since the lead auditor is ultimately responsible for reviewing and retaining all documentation required by AS 1215.19, it is unclear why only documentation required under paragraph .B2a and .B2.d is mentioned in paragraph .B3 and documentation under .B2.b and .B2.c is excluded from the paragraph.

Question 8. *Is the revision to the proposed standard relating to the division of responsibility when the company and its business unit use different reporting frameworks appropriate and clear?*

This revision relating to the division of responsibility seems clear. However, similar to other circumstances where the lead auditor refers to other auditors, if the lead auditor indicates that the referred-to auditor audited conversion adjustments, then this reference may be construed as a disclaimer of responsibility by certain various groups (e.g., investors, attorneys, jurors). Contemporaneous research around Critical Auditing Matter (CAM) disclosures finds that these disclosures reduce users' assessments of auditor responsibility for misstatements in the same area as the CAM (e.g., Kachelmeier, Schmidt, and Valentine 2017). This suggests that the proposed requirement for the lead auditor to indicate that the referred-to auditor audited the conversion adjustments may, perhaps unintentionally, mitigate the lead auditor's legal liability. We encourage the Board to consider clarifying the proposed standard to avoid this potential unintended effect.

Relatedly, research demonstrates that certain investor groups have difficulty weighing information about the audit in their valuation judgments (e.g., Vera-Munoz, Gaynor, McDaniel, and Kinney 2015; Kachelmeier et al. 2017), but visual cues in financial reports (such as those provided in "Circle-ups" that accompany letters to underwriters) can facilitate users' weighting of this information (Dennis, Griffin, and Johnstone 2017). We, therefore, encourage the Board to consider mechanisms (such as "Circle-ups") that may aid in facilitating user's weighting of such information by linking audit report information about referred-to auditors with the related amounts and disclosures in the financial statement.

Question 10. *Comment is requested on the matters discussed in this section. Would any revisions the Board is considering for adoption affect the scalability of PCAOB standards in this area? Would any have a significant effect on the competitiveness of smaller audit firms? Would the revisions significantly change the costs and benefits associated with the proposed changes discussed in the 2016 Proposal? Are there any unintended consequences that the Board should consider? Are there any other matters not addressed in this release the Board should consider in its economic analysis?*

Although existing rules require any auditor that "play[s] a substantial role in the preparation or furnishing of an audit report" (Rules 2100, 1001) register with the PCAOB, the modification proposed to paragraph B5 may be perceived as lowering the threshold requirement for registration. If so, extant research suggests some smaller auditors may exit the issuer-audit market (e.g., Abbot, Gunny, and Zhang 2012; Daugherty, Dickins, and Tervo 2011). That said, it is likely that the number of impacted auditors would be small. Additional documentation requirements proposed to be mandated (e.g., paragraph B4) will likely add to the cost of conducting an audit, and these costs will likely be passed along to issuers in the form of higher audit fees.

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Please note that the comments expressed herein are solely my personal views

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Chris Barnard
Actuary

17 October 2017

- **Release No. 2017-005**
- **PCAOB Rulemaking Docket Matter No. 042**
- **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**

Dear Sir.

Thank you for giving us the opportunity to comment on your Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Accounting Firm. You are issuing a supplemental request for comment on your April 12, 2016, proposed amendments and proposed standard regarding audits that involve accounting firms and individual accountants outside the accounting firm that issues the audit report. This supplemental request for comment seeks commenters' views on certain revisions to the proposed amendments and proposed standard that you are considering for adoption, and on other matters discussed in the release. You are also reopening the comment period for the proposed amendments and proposed standard, for additional comments on any other aspects of the proposal.

I support these proposed changes, which will increase the accountability of the lead auditor and should increase the quality of the lead auditor's performance. This should lead to improvements in the quality of audits and financial reporting, which will increase market certainty and promote confidence in financial markets.

Concerning the proposed definitions, I would only recommend in addition that we should aim for consistent terminology and definitions across PCAOB, IAASB and ASB standards. This would improve clarity and regulatory efficiency with no loss of amenity.

Please note that the comments expressed herein are solely my personal views

Yours faithfully

C.R.B.

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November 15, 2017

Via E-mail: comments@pcaobus.org

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Re: PCAOB Release No. 2017-005, Rulemaking Docket Matter No. 042: *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*

Dear Office of the Secretary:

BDO USA, LLP appreciates the opportunity to respond to the request for comments on the Public Company Accounting Oversight Board's (the PCAOB or the Board) Release No. 2017-005: *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* (the proposed amendments and proposed standard, respectively) (the Release). As previously expressed in our comment letter dated July 29, 2016 on this topic, we support the PCAOB's efforts to strengthen the auditing standards relating to audits in which other auditors participate, and in particular where other auditors operate in different countries with differing cultures, languages, or economic markets. While we are supportive of the Board's efforts to improve audit quality and appreciative of the consideration of comments previously received, we have included below our additional thoughts on the Supplemental Request for Comment, which are consistent with our previous view that a risk-based supervisory approach is the best approach to enhancing audit quality and serving the public interest. Our comments align with the topical sections set out within the Supplemental Request for Comment, and generally focus on audit planning and supervision of other auditors.

Audit Planning

Definitions

In our prior comment letter, we suggested broadening the definition of 'lead auditor' to recognize the differing firm practices that may allow for personnel sharing between network firms, in particular seconded employees, that may work on a U.S. public company engagement under the direct supervision of the U.S. engagement partner but retain their employment status with the foreign firm. We note that the Release, starting on page 33, discusses the proposed definition of 'Lead Auditor' and explains 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.'



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However, this concept is not included in the definition of lead auditor within the proposed amendments to AS 2101. To clarify the definition of lead auditor, consistent with the explanatory material in the forepart of the Supplemental Request for Comment, we suggest including this explanation in a note to AS 2101.A4.

Another area where we believe additional context provided within the forepart of the Release would be helpful within the standard relates to the definition of 'Other Auditor.' We note that footnote 20 on page 12 of the Release explains that the proposed definition of 'other auditor' includes both a firm and individuals from that firm, and that as a practical matter, this requirement would typically be applied at the firm level because the other auditor firm would typically have both the processes for determining compliance with PCAOB independence and ethics requirements and SEC independence requirements and some level of experience in applying those requirements. We agree with this explanation, and believe that it would provide helpful context in consistent application of the standard if the content from this footnote was incorporated as a note to the definition of 'other auditor' in AS 2101.A5.

Independence and Ethics

As explained in the Release, the Board has proposed to require auditors to gain an understanding of the other auditor's process for determining compliance with the independence and ethics requirements, rather than understand the other auditor's knowledge of the requirements, as proposed in the 2016 Proposal.^{1, 2} Specifically, the 2016 proposal would have required the auditor to understand each other auditor's knowledge of independence and ethics requirements and experience in applying the requirements, and obtain a written representation from each other auditor.

We believe the proposed requirement to require each lead auditor at an engagement team level to gain an understanding of each other auditor's processes represents a significant change in current practice without an apparent benefit. Additionally, we are uncertain of the ability of a lead auditor to evaluate the adequacy of the processes of the other auditor's firm, since such an evaluation would likely require specialized subject matter experts to be involved. Moreover, the level of detail provided by an other auditor may not be sufficiently robust to provide the lead auditor with an understanding of the process for determining compliance with the SEC independence requirements and PCAOB independence and ethics requirements.

The proposed requirement to obtain the written representation from the other auditor that it is, or is not, in compliance with SEC independence requirements and PCAOB independence and ethics requirements, in addition to a representation that the other auditor has appropriate policies and procedures in place for assessing such compliance, would appear to be sufficient for the lead auditor to determine each other auditor's compliance with SEC independence requirements and PCAOB independence and ethics requirements, particularly since it is the

¹ PCAOB Release No. 2017-005, page 12.

² The 2016 Proposal refers to PCAOB Release No. 2016-002: *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard - Dividing Responsibility for the Audit with Another Accounting Firm (April 12, 2016)*



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responsibility of each audit firm to maintain systems and processes to comply with SEC independence requirements and PCAOB independence and ethics requirements. Only when deemed necessary, based on risk, should the lead auditor consider performing additional procedures.

We note that the Release explains that 'information obtained by the lead auditor about the other auditor could either support or contradict the other auditor's representation regarding compliance with independence and ethics requirements or the written description of 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.'³ The sources of this information, as listed in the Release, include regulatory reports or news articles. If there is an expectation for the lead auditor to perform such searches, we suggest including this language in the body of the standard. Moreover, in general, we believe content within the Release that provides helpful application guidance should be included within the standard itself to ensure consistent application by all practitioners.

Other Auditors: Qualifications and Communication

Proposed AS 2101.14 states that in an audit that involves other auditors or referred-to auditors, the lead auditor should hold discussions with and obtain information from the other auditors or referred-to auditors, as necessary, to assess risk and determine the locations or business units at which audit procedures should be performed. However, in circumstances where the lead auditor refers to the work of an other auditor, the lead auditor does not take responsibility for the work of the referred-to-auditor, and as such, it would be inconsistent with the division of responsibility to require the lead auditor to hold discussions with the other auditor as part of risk assessment. Furthermore, with respect to equity method investees, there are often challenges in engaging in discussions with such entities and, in practice, company management may not always have direct access to investee management. For these reasons, we do not believe such discussions should be required.

We note the Board is also considering a new requirement for the lead auditor to inquire about the other auditor's policies and procedures relating to the (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.⁴ While we agree it is important for the lead auditor to understand the knowledge, skill, and ability of the other auditors who assist the lead auditor with planning and supervision, we do not believe it is necessary to require the lead auditor to inquire about the other auditors' policies and procedures relating to assignment and training of individuals for two reasons. First, as part of understanding the knowledge, skill, and ability of the other auditor who assists in supervision, it would be reasonable for the lead auditor to expect that such supervision would include ensuring the work performed is appropriate and performed with due care. Second, an other auditor's response to a request for policies and procedures with respect to job assignment and

³ PCAOB Release No. 2017-005, page 14.

⁴ PCAOB Release No. 2017-005, page 15.



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training would likely not result in a communication with the degree of granularity to permit the lead auditor to evaluate the effectiveness of such policies and procedures. Accordingly, we suggest deleting proposed paragraph 2101.B6a., and adding the concept of the performance of a review, in addition to planning and supervision, to the requirement for the lead auditor as follows (deletions in bold strike through text and additions in bold italics):

.B6b. Gain an understanding of the knowledge, skill, and ability of the other auditors who assist the lead auditor with planning, ~~or~~ supervision, ***or review***, including their...

Supervision of the Audit Engagement

Communication

Paragraph .B2a(2) of AS 1201 requires the auditor to inform the other auditor about the identified risks of material misstatement, among other matters, and the footnote to this guidance refers to AS 2110, *Identifying and Assessing Risks of Material Misstatement*, (AS 2110) paragraphs 49-51. These paragraphs in AS 2110 provide guidance regarding the conduct of discussions among engagement team members regarding risks of material misstatement and in particular, paragraph .51 refers to communication among the engagement team members about significant matters affecting the risks of material misstatement. Consistent with AS 2110.51, we believe the guidance in .B2a(2) should be focused on the more significant matters affecting the risks of material misstatement.

Multi-tiered Audits

The proposed procedures to be performed when the engagement team is organized in a multi-tiered structure include a requirement for the lead auditor to obtain, review, and retain a copy of the summary memorandum provided by the second other auditor to the first other auditor without consideration of a risk-based supervisory approach. We believe such a requirement would result in redundancies in work effort between the lead auditor and the first other auditor without an increase in audit quality. The first other auditor's supervision over the second other auditor should be sufficient to inform the lead auditor whether additional procedures may be necessary, in particular given the lead auditor's assessment of the knowledge, skill, and ability of the first other auditor during the planning phase of the audit.

Effective Date

Given the nature and scope of the changes being proposed, the development of policies and procedures to implement the changes will require international coordination, which will take time to operationalize. For this reason, we suggest the proposed standard and amendments be effective for audits of fiscal years beginning no sooner than two years after approval by the SEC (or for audits of fiscal years beginning three years after the year of SEC approval if that approval occurs in the third or fourth quarter).

* * * *



Office of the Secretary
Public Company Accounting Oversight Board
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We appreciate your consideration of our comments and suggestions and would be pleased to discuss them with you at your convenience. Please direct any questions to Christopher Tower, National Managing Partner - Audit Quality and Professional Practice at 714-668-7320 (ctower@bdo.com), Phillip Austin, National Managing Partner - Auditing at 317-730-1273 (paustin@bdo.com), or Patricia Bottomly, Partner - National Assurance at 310-557-8538 (pbottomly@bdo.com).

Very truly yours,

/s/ BDO USA, LLP

BDO USA, LLP



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November 21, 2017
Office of the Secretary
PCAOB
1666 K Street, NW
Washington, D.C. 20006-2803

comments@pcaobus.org

Subject: Comments on PCAOB Rulemaking Docket Matter No. 042 (PCAOB Release 2017-005)
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

The California Society of CPA's ("CalCPA") Accounting Principles and assurance Services Committee (the "Committee") is the senior technical committee of CalCPA. CalCPA has approximately 43,500 members. The Committee consists of 55 members, of whom 45 percent are from local or regional firms, 32 percent are from large multi-office CPA firms, 12 percent are sole practitioners in public practice, 6 percent are in academia and 5 percent are with CPA firms serving a large number of public and nonpublic business entities, as well as many non-business entities such as not-for-profits, pension plans and governmental organizations.

The Committee has provided responses to the specific questions set forth in the release below.

Question:

- 1. Is the revised requirement for determining the sufficiency of participation to serve as lead auditor, based on risk and importance of the locations, appropriate and clear?**

The Committee supports the Board's additional criteria based on the evaluation of risk and the importance of the locations or business units for which the lead auditor performs procedures (on a disaggregated basis). The Committee agrees that qualitative considerations should be given prominence in the evaluation, while still taking into account quantitative considerations.

- 2. Is the additional sufficiency threshold for divided responsibility engagements clear? Should this be a bright-line requirement, or does this threshold need to allow for exceptional situations? Are there any other implications of this threshold that the Board should consider, such as investor protection implications or auditing challenges related to the revised requirement?**

The Board's reference to the quantitative sufficiency criterion ("The participation of the engagement partner's firm to serve as lead auditor ordinarily is not sufficient if the referred-to auditors, in aggregate, audit more than 50 percent of the company's assets or revenues.") does reflect what the profession has long utilized in practice. The Committee also agrees with the Board's position that the additional sufficiency standard creates a presumption that the lead auditor will not divide responsibility with an audit firm (or firms) that audits a majority of the company's assets or revenue.

However, the Committee believes that because SEC and other regulatory rules are subject to change, the PCAOB should replace the proposed explicit 50% quantitative threshold reference with a general requirement that the engagement partner consider existing regulatory requirements, including for example, those established by the SEC. The Committee also recommends that: (1) the provision for documenting an exceptional situation to presumptive regulatory requirements (including the 50% threshold provision) be included to provide flexibility, and (2) the Board clarify that the quantitative evaluation should not be performed to the exclusion of the evaluation of the relative importance of individual business units audited by the lead and other auditors.

To accomplish these objectives, the PCAOB could establish a third item "c" in paragraph .B2 of the proposed changes to AS 2101 noting that an engagement partner should also take into account the following incremental matter:

c. Existent regulatory requirements which may preclude the engagement partner's firm from serving as lead auditor, including for example, requirements established by the Securities and Exchange Commission. In the rare circumstances in which the engagement partner believes the objectives of presumptive regulatory requirement(s) can be met by alternative means, the lead auditor must document the information that demonstrates that the objectives were achieved.

The Committee is not aware of additional challenges that need to be considered regarding the implementation of the revised requirement.

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

The Committee supports the Board's consideration of a requirement for the lead auditor to obtain 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 from each other auditor that it is in compliance with independence and ethics requirements. This requirement is more robust than the current process, whereby the lead auditor typically can limit its procedures to obtaining confirmation that the other auditor is familiar with, and has complied with, the SEC and PCAOB independence requirements. The Committee also supports the Board allowing the acceptance of the other

auditor's representations regarding compliance to encompass all covered persons of that firm versus the current practice of obtaining representations only from the individuals assigned to the engagement team.

However, the Committee believes the Board's additional requirement to obtain an understanding of the other auditor's "process for determining compliance" should be accompanied by further clarification of the means to obtain such information as it may not be operational as currently drafted. The Committee also suggests that the Board include its rationale for not allowing "reliance" on network independence standards. It would be helpful to understand if this presumption can be overcome in a situation where a network has sufficient procedures in place to ensure compliance by member firms, assuming the network has established definitive independence guidance, and the network firms are subject to periodic inspections. Otherwise, some practitioners may find the only way to satisfy the Board's proposed requirement would be to obtain the other auditor's independence process documents as set forth in the other auditor's quality control document and perform inquiries tantamount to those undertaken in an inspection or peer review. The Committee believes that such a requirement is unnecessary and may duplicate procedures performed during the other auditor's peer review or PCAOB inspections and made evident within corresponding review/inspection reports.

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

The Committee believes the Board's additional requirement to obtain an understanding of the other auditor's "process for training and assigning personnel" at the firm wide level for determining compliance should be accompanied by further clarification of the means to obtain such information as it may not be operational as currently drafted. The Committee also suggests that the Board include its rationale for not allowing "reliance" on network training and personnel assignment standards. It would be helpful to understand if this presumption can be overcome in a situation where a network has sufficient procedures in place to insure compliance by member firms, assuming the network has established definitive training and the qualification requirements for persons assigned to PCAOB audits, and the network firms are subject to periodic inspections. The Committee believes it is sufficient to gain an understanding of the background and training of those specific individuals to be assigned to the PCAOB audit, rather than focusing on the other auditor's system of training and supervision specified in that firm's quality control document. The Committee believes the Board's proposed expansion of the lead auditor's responsibilities regarding evaluating the other auditor's independence, training and assigning personnel to be the equivalent of performing "inspection like procedures" that are unnecessary in the context of a specific audit engagement, especially for network firms. As discussed in the Committee's response to Question 3 above, the Board should provide further clarification, including under what circumstance the lead auditor could place reliance on the other auditor's PCAOB inspection reports, network inspection findings or peer review reports, if available.

- 5. Are the proposed new addition to AS 1015 and revision to AS 1201 relating to the other auditors' responsibility appropriate and clear? Is it clear that AS 1015 already applies to referred-to auditors that perform audits under PCAOB standards?**

The Committee supports the Board's requirement to obtain a summary memorandum from the other auditor, and the provision to allow tailoring the contents of all communications between the lead auditor and other auditor depending on the nature of the work performed on the audit by other firms (without specifying the contents of such communications).

- 6. Are the proposed new additions to AS [12]01.B2 appropriate and clear? Also, is it clear that the necessary level of detail of the other auditor's audit documentation that the lead auditor obtains and the necessary extent of the lead auditor's review according to requirements in proposed Appendix B of AS 1201 are scalable based on the factors in the existing standard regarding the necessary extent of supervision?**

The Committee supports the additional proposed guidance in AS 1201.B2 regarding the level of detail in the other auditor's documentation to be obtained and reviewed by the lead auditor. The Committee also believes the extent of the lead auditor's review are scalable in accordance with the requirements in proposed Appendix B of AS 1201.

- 7. Are the revised proposed requirements for situations in which the lead auditor directs an other auditor to perform supervisory procedures with respect to a second other auditor on behalf of the lead auditor clear? If not, how should the revised proposed requirements be revised?**

The Committee believes the Board's proposed requirements for the lead auditor to obtain, review and retain certain documents related to the work performed by the other auditors, including the work of the second tier auditor(s) in a multi-tiered audit as reasonable under the circumstances.

- 8. Is the revision to the proposed standard relating to the division of responsibility when the company and its business unit use different reporting frameworks appropriate and clear?**

The Committee believes the Board's proposal to allow for a situation in which financial statements of a component are prepared under a different financial accounting framework (IFRS for example), by having either the lead or referred-to auditor audit the conversion adjustments, to be appropriate and clear.

- 9. Is it clear how the proposed amendments and new standard (as revised by this release) relate to other amendments to auditing standards proposed or adopted by the Board since the 2016 Proposal?**

The Committee believes the proposed amendments and new standard are appropriately integrated into the existing PACOB auditing standards.

10. Comment is requested on the matters discussed in this section. Would any revisions the Board is considering for adoption affect the scalability of PCAOB standards in this area? Would any have a significant effect on the competitiveness of smaller audit firms? Would the revisions significantly change the costs and benefits associated with the proposed changes discussed in the 2016 Proposal? Are there any unintended consequences that the Board should consider? Are there any other matters not addressed in this release the Board should consider in its economic analysis?

The Committee believes the most significant additional cost factor arising from the revisions to the original proposal is the expansion of work required to be undertaken by the lead auditor to obtain an understanding of the other auditor's process for determining compliance with the PCAOB's independence and ethics requirements and process for training and assigning personnel. These requirements will be more burdensome on smaller registered audit firms, and may have the negative affect of reducing the available pool of interested firms able and willing to perform these types of audits in a cost effective manner. The Committee has no additional comments.

We thank you for the opportunity to comment on this matter. We would be glad to discuss our opinions with you further should you have any questions or require additional information.

Sincerely,



Matthew J. Lombardi
Chair
Accounting Principles and Assurance Services Committee
California Society of Certified Public Accountants

California State Teachers'
Retirement System
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November 7, 2017

Phoebe W. Brown, Secretary
Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

Re: Release No. 2017-005, Public Company Accounting Oversight Board (PCAOB) Rulemaking Matter No. 042 - **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**

Dear Ms. Brown and PCAOB Board Members:

I am writing on behalf of the members of the California State Teachers' Retirement System (CalSTRS) in response to the Public Company Accounting Oversight Board's (PCAOB, Board) request for written comments to Docket Matter No. 042 - Supplemental Request regarding the supervision of audits involving other auditors and Proposed Auditing Standard – Dividing responsibility for the audit with another accounting firm.

CalSTRS' mission is to secure the financial future and sustain the trust of California's educators. We serve the investment and retirement interests of more than 914,454 plan participants and their beneficiaries.¹ CalSTRS is the largest educator only pension fund in the world, with a global investment portfolio valued at approximately \$215 billion as of September 30, 2017.²

The long-term nature of CalSTRS liabilities, the composition of its portfolio and the Teachers Retirement Board's fiduciary responsibility to its members, make the fund keenly interested in the rules and regulations that govern the securities market. With such a large part of our investment portfolio exposed to the risks and rewards of the public equity markets, CalSTRS is grateful for the work done by the PCAOB to promote investors' protection. We have a vested interest and rely on the quality and integrity of financial reporting and believe a robust auditor's report is integral to our capital allocation analysis done on behalf of our beneficiaries. We appreciate the opportunity to comment since audits of many international companies may include significant amount of work that

¹ CalSTRS at a Glance, Fact Sheet: <http://www.calstrs.com/sites/main/files/file-attachments/calstrsataglance.pdf>

² CalSTRS Current Investment Portfolio for the period ending September 30, 2017.
<http://www.calstrs.com/current-investment-portfolio>

Phoebe W. Brown, Secretary

11/7/2017

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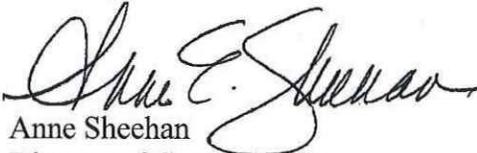
is performed by accountants other than the firm issuing the audit report. CalSTRS agrees with the PCAOB the work of other auditors may account for a significant share of the audit and may involve areas of high risk of material misstatement. We appreciate the importance of the proposed audit standard to ensure the sufficient appropriate evidence is obtained through the work of the lead auditor and other auditors to support the lead auditor's opinion in the audit report.

CalSTRS support the proposed changes which will improve and increase the accountability of the lead auditor and should increase audit quality and performance. We agree the lead auditor should inform the other auditor of the necessary level of detail of the other auditor's information to articulate and document the responsibilities of the lead auditor in the supervision of the other auditor's work. Additionally, we continue to support the requirement of the lead auditor to communicate to the audit committee about the other auditor's involvement as well as provide a copy of the written representation from the referred to auditor that provides appropriate representation of independence, and licensed to practice under the laws of the jurisdiction.

We believe the proposed amendments and audit standard will support the intent of the PCAOB's new auditor's reporting standard with additional clarification of responsibilities and guidance on the work of other auditors. CalSTRS believes the new auditor reporting standard recently approved by the SEC is the foundation for robust communication not only to audit committees but to investors which depend on the independence and critical judgment of the auditor.

We commend the PCAOB for taking steps to improve meaningful disclosures and improvement in audit standards. If you would like to discuss this letter further, please feel free to contact me at my number above or Mary Hartman Morris at 916-414-7412, MMorris@CalSTRS.com.

Sincerely,



Anne Sheehan

Director of Corporate Governance

California State Teachers' Retirement System



**CENTER
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November 15, 2017

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Re: PCAOB Release No. 2017-005, Rulemaking Docket Matter No. 042:
*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*

Dear Office of the Secretary:

The Center for Audit Quality (CAQ) is an autonomous public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. The CAQ fosters high quality performance by public company auditors, convenes and collaborates with other stakeholders to advance the discussion of critical issues requiring action and intervention, and advocates policies and standards that promote public company auditors' objectivity, effectiveness, and responsiveness to dynamic market conditions. Based in Washington, DC, the CAQ is affiliated with the American Institute of CPAs.

The CAQ welcomes the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or the Board) Release No. 2017-005: *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* (individually the proposed amendments and proposed standard, respectively, and collectively, the Supplemental Request for Comment or Release).¹ This letter represents the observations of the CAQ but not necessarily the views of any specific firm, individual, or CAQ Governing Board member.

As we have previously expressed, the CAQ shares the PCAOB's goal of improving audit quality and supports the PCAOB's consideration of revisions to auditing standards guiding the supervision of other auditors as public companies and their auditors become increasingly global.² In general, we appreciate the careful consideration the Board has given to comment letters received on Release No. 2016-002: *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Accounting Firm*³ and the explanations in the Supplemental Request for Comment which provide the Board's perspective and considerations on

¹ See <https://pcaobus.org/Rulemaking/Docket042/2017-005-other-auditors-SRC.pdf>.

² See the CAQ's [comment letter](#) on this topic dated July 29, 2016.

³ See <https://pcaobus.org/Rulemaking/Docket042/2016-002-other-auditors-proposal.pdf>.

the comments. In this letter, we offer for the Board's consideration our views regarding certain amendments to existing and proposed auditing standards as outlined in the Supplemental Request for Comment.

Our views are organized into the following sections:

- I. Comments on Amendments to Auditing Standard 2101, *Audit Planning* (AS 2101)
- II. Comments on Amendments to Auditing Standard 1201, *Supervision of the Audit Engagement* (AS 1201)
- III. Other Matters

I. Comments on Amendments to Auditing Standard 2101, *Audit Planning* (AS 2101)

Definitions

Lead Auditor

The Supplemental Request for Comment clarifies the lead auditor definition by stating "seconded 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."⁴

We suggest further clarifying the definition of lead auditor by adding the following note to AS 2101.A4 (as well as in other applicable standards where lead auditor is defined):

Note: Individuals working under the lead auditor's guidance and control (which may include secondees from other accounting firms, employees of shared service centers, and other individuals who work in the role of firm employees) should be treated as employees of the lead auditor's firm for purposes of defining the lead auditor.

Other Auditor

In the context of other auditors' compliance with independence and ethics requirements, the Board clarified the definition of other auditor in footnote 20 on page 12 of the Release text, which states:

"The proposed definition of "other auditor" includes both a firm and individuals from that firm. As a practical matter, this requirement would typically be applied at the firm level because the other auditor firm would typically have both the processes for determining compliance with PCAOB independence and ethics requirements and SEC independence requirements and some level of experience in applying those requirements. This requirement would be applied at the individual level for participating persons who are not part of a firm."

This clarification, as it relates to the definition of other auditor, is important as certain proposed amendments could otherwise be interpreted such that the lead auditor would be required to perform certain procedures for individual members of the other auditor's engagement team, which may result in unnecessary effort and cost.

We suggest further clarifying the definition of other auditor by adding the following note to AS 2101.A5 (as well as in other applicable standards where other auditor is defined):

⁴ Supplemental Request for Comment, page 34.

Note: The definition of "other auditor" includes both a firm and individuals from that firm. Certain requirements would typically be applied at the firm level, as a practical matter. For participating persons who are not part of a firm, certain requirements would be applied at the individual level, as applicable.

Lead Auditor Determination

The Board has proposed changes to AS 2101.B2 to add the “importance of the locations or business units 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 quantitative and qualitative factors” as a criterion in determining the sufficiency of participation to serve as lead auditor. We still have concerns that there could be scenarios where no one auditor would meet the criteria of proposed AS 2101.B2, such as when no individual auditor audits the risks of material misstatement associated with a larger portion of the company’s financial statements.

The determination of a lead auditor should take into account other qualitative considerations, such as legal and licensing requirements of certain jurisdictions.

For example:

Company A is domiciled in the US. Most of the officers and directors are based in the US. However, substantially all the operations take place in Country B, including all accounting and back office functions. Further, substantially all day-to-day accounting and financial reporting decisions are made in Country B with direction from the US-based management. Accounting Firm X in the US may not meet the sufficiency requirement for lead auditor under the proposed amendments because the risks of material misstatement associated with the larger portion of the company’s financial statements are directly audited by Accounting Firm Y in Country B, and it is not clear how to apply the relative importance criterion in this circumstance. However, Accounting Firm Y from Country B cannot meet the legal and regulatory requirements to issue an auditor’s report for Company A, because Accounting Firm Y cannot meet the licensing requirements in the US. Similarly, Accounting Firm X may not be able to directly perform audit procedures in Country B because of licensing or other laws and regulations governing public accounting in Country B. We believe, however, that if Accounting Firm Y is under the direction and supervision of Accounting Firm X and as such, there is sufficient involvement of Accounting Firm X in the work performed by Accounting Firm Y, Accounting Firm X can serve as lead auditor.

Other Auditors’ Compliance with Independence and Ethics

We believe it is important for the lead auditor to consider whether the other auditor has complied with the Securities and Exchange Commission (SEC) independence and PCAOB independence and ethics requirements (collectively, Regulatory Independence/Ethics Requirements). The Board is considering an amendment to AS 2101.B4, which states:

In an audit that involves other auditors, the lead auditor should determine each other auditor’s compliance with the SEC independence requirements and PCAOB independence and ethics requirements by:

- a. Gaining an understanding of each other auditor’s (1) process for determining compliance with the SEC independence requirements and PCAOB independence and ethics requirements and (2) experience in applying the requirements...⁵

⁵ Supplemental Request for Comment, page A2-12.

We have significant concerns related to the implementation of this proposed amendment. Requiring each lead auditor at an engagement team level to gain an understanding of each other auditor's processes (even at the firm level of the other auditor) represents a significant change in existing practice, without a clear understanding of the added benefit. It is the responsibility of each audit firm to maintain systems and processes to comply with Regulatory Independence/Ethics Requirements. To require the lead auditor to take on the responsibility for assessing another firm's processes for compliance with Regulatory Independence/Ethics Requirements would be difficult, if not impossible to execute due to practical challenges. As a result, we do not believe such a requirement will necessarily strengthen compliance and could add significant costs.

We do not believe the proposed amendment (AS 2101.B4a) would be effective as the lead auditor may not be in the best position to evaluate the processes of the other auditor's firm, which include a complex evaluation typically performed by specialized subject matter experts at a firm level. In addition, policies and procedures are proprietary to firms which may hinder the other auditor's ability to share this information. There are practical challenges due to data privacy and confidentiality restrictions particularly with out-of-network other auditors and other auditors in certain jurisdictions. Consequently, the lead auditor may not be able to effectively gain an understanding of the process for determining compliance with Regulatory Independence/Ethics Requirements as they are likely to receive a generic type response. In addition, the proposed amendment would not be efficient as it would result in a duplication of effort across many engagement teams, for both lead auditors and other auditors.

The written representation has an important role to play in considering the independence of the other auditor. Relying on a written representation is premised on consideration of a firm's system of quality control, which we believe is a crucial element of the supervision of audits that involve other auditors. We believe this is only appropriate after the auditor has obtained evidence that the other auditor has a system of quality control that is designed and operating effectively. This evidence provides the basis for relying on the system of quality control and ultimately, the written representation from the other auditor. Only when there is no such basis for reliance on the system of quality control should the lead auditor consider performing incremental procedures.

We recommend amending AS 2101.B4 as follows:

.B4 In an audit that involves other auditors, the lead auditor should ~~determine~~ obtain evidence about each other auditor's compliance with the SEC independence requirements and PCAOB independence and ethics requirements by:

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

~~b. Obtaining from each other auditor:~~

(1) 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; and

(2) A written representation stating that:

(a) The other auditor has appropriate policies and procedures in place for assessing compliance with SEC independence requirements and PCAOB

independence and ethics requirements, including consideration of matters that may reasonably be thought to bear on independence; and

(b) It is, or is not, in compliance with SEC independence requirements and PCAOB independence and ethics requirements and, if it is not, a description of the nature of any noncompliance.

Note: If the lead auditor becomes aware of information during the course of the audit that contradicts an other auditor's description of its relationships that may reasonably be thought to bear on independence or a representation made by an other auditor regarding its compliance with the SEC independence requirements and PCAOB independence and ethics requirements, or the appropriateness of the other auditor's policies and procedures, the lead auditor should perform additional procedures to determine the effect of such information on the independence of the other auditor.

Related to the note above in AS 2101.B4, the Release text states “[r]elevant information about the other auditor may come either directly from the other auditor *or from other sources, such as regulatory reports or news articles.*”⁶ This statement causes uncertainty as to whether there is an expectation for the lead auditor to undertake a search for such information to comply with the requirements contained in the standard itself.

Qualifications of and Communication with Other Auditors

In determining the locations or business units at which audit procedures should be performed, proposed AS 2101.14 states 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. This requirement encompasses all risks of material misstatement and not only the significant risks, and as such would go well beyond current standard practice in that such granular discussions would not necessarily take place between lead auditors and each other auditor, although it might be an appropriate response in certain circumstances, based on the judgment of the lead auditor.

In addition, there could be particular challenges in engaging in these discussions with auditors of equity method investees because the lead auditor or company does not have the right or ability to interact with the other auditor. It is our understanding that the investee's auditor may not be under any obligation to engage in such discussions with the lead auditor and provide such detailed information. For many noncontrolling investments, company management may not always have direct access to investee management to arrange for the company's auditor to perform the proposed procedures, and in some cases the company may not be entitled to such information pursuant to the terms of the investment arrangement. The Release notes these requirements are conditioned on, and limited to, the extent to which such discussion is necessary to identify and assess the risks to the consolidated financial statements associated with the location or business unit. However, we believe it is necessary for the PCAOB to provide guidance on how the lead auditor would comply with these requirements if direct interaction with an other auditor is not possible.

We note that the PCAOB is considering wider changes to the auditing standards relating to *Auditing Accounting Estimates, including Fair Value Measurements*.⁷ The PCAOB should consider aligning the requirements of these proposed amendments and changes to auditing standards relating to *Auditing Accounting Estimates, including Fair Value Measurements* to achieve its objectives when finalized.

⁶ Supplemental Request for Comment, page 14.

⁷ PCAOB Release No. 2017-002.

The Board is also considering a new requirement for the lead auditor to inquire about the other auditors' policies and procedures relating to assignment and training of individuals, and gaining an understanding of the knowledge, skill, and ability of the other auditors who assist the lead auditor with planning or supervision.⁸ While we agree that consideration of the other auditor's knowledge, skill, and ability is important to determine the nature, timing, and extent of supervision necessary (and this is already required by AS 1201.06), inquiring about how other auditors assign individuals to audits and train individuals may not be practical for the lead auditor, as such policies and procedures may be considered confidential and proprietary in nature. Consequently, the lead auditor may not be able to effectively gain the necessary understanding of the policies and procedures related to the assignment and training of individuals to the audit as they are likely to receive a generic type response. If the lead auditor did receive detailed policies and procedures from the other auditor, we are concerned this requirement would incur significant time and cost without a benefit to audit quality. Gaining an understanding of the knowledge, skill, and ability of other auditors who assist the lead auditor with planning, supervision, or review enables the lead auditor to appropriately vary the extent of supervision.

We suggest the following revision to proposed AS 2101.B6:

.B6 At the beginning of an audit that involves other auditors, the lead auditor should:

~~a. Inquire about other auditors' policies and procedures relating to the:~~

~~(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 an understanding of the knowledge, skill, and ability of the other auditors who assist the lead auditor with planning, ~~or~~ supervision, or review, 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;~~

II. Comments on Amendments to Auditing Standard 1201, *Supervision of the Audit Engagement (AS 1201)*

Lead Auditor Communications

The proposed approach in paragraph .B2a(2) of AS 1201 would require the lead auditor to inform the other auditor, in writing, of the "tolerable misstatement, the identified risks of material misstatement and, if determined, the amount below which misstatements are clearly trivial and do not need to be accumulated relevant to the work requested to be performed."

This requirement to communicate identified risks of material misstatement presents a significant increase in the communications and level of work currently being performed in relation to interactions between lead auditors and all other auditors, and we do not believe it will necessarily have a commensurate benefit. We

⁸ AS 2101.B6.

believe communicating *all* identified risks of material misstatement in all cases is too broad of a requirement. We have a concern that the lead auditor may not always be in a position to identify the complete listing of risks at a location or business unit, and the other auditor should be leveraged in this regard. We suggest modifying the proposed amendments to require communication by the lead auditor of significant matters identified from discussions with engagement team members of risks of material misstatement as required by Auditing Standard 2110, *Identifying and Assessing Risks of Material Misstatement* (AS 2110) paragraphs .49 - .51.

When the other auditor performs a full scope audit of the location or business unit, the other auditor is required to identify the risks of material misstatement at the location or business unit level. In these situations, the other auditor can communicate such risks to the lead auditor.

We suggest the following revision to proposed AS 1201.B2:

.B2 In supervising the work of other auditors, the lead auditor should:

a. Inform the other auditor of the following in writing:

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

(2) Tolerable misstatement, significant matters identified from discussions with engagement team members of the identified risks of material misstatement as required by AS 2110.49-.51, and, if determined, the amount below which misstatements are clearly trivial and do not need to be accumulated relevant to the work requested to be performed.

Review of Specified Documentation, including Summary Memorandum

Proposed amendment AS 1201.B2c requires the lead auditor to “[d]irect the other auditor to provide for review specified documentation with respect to the work requested to be performed...” We believe that in a risk-based approach, the determination of documentation to be reviewed is determined by multiple factors, including the professional competence of the other auditors and the risks of material misstatement addressed by their work. For example, there could be a scenario where the lead auditor determines that they only require additional documentation related to significant risks, which would be duplicative of the requirements of Auditing Standard 1215, *Audit Documentation* (AS 1215) paragraph 19b. Auditors would benefit from guidance and examples related to the new requirements proposed in AS 1201.B2. We request that the Board clarify that there may be certain situations where it is not necessary to obtain specified documentation beyond AS 1215.19 (such as if the lead auditor determines that the extent of supervision provided is sufficient and they were involved in the planning, execution, and conclusions regarding the procedures performed by the other auditor).

In situations where the lead auditor determines it appropriate to direct the other auditor to provide workpapers, there should be some acknowledgement that there may be restrictions in certain jurisdictions. In particular, when non-network firms are used, the ability of the lead auditor to obtain workpapers or language barriers might broadly affect the lead auditor’s ability to review workpapers. It would be useful for the Board to acknowledge that specified documentation obtained by the lead auditor may include a summary of the procedures performed.

Therefore, we suggest the following revision to proposed AS 1201.B2c:

Direct the other auditor to provide for review specified documentation with respect to the work requested to be performed, as necessary.

The Board is considering a revision to AS 1201.B2d to require the lead auditor to obtain a summary memorandum instead of a written report describing the other auditor's procedures, findings, conclusions, and, if applicable, opinion. The Board should clarify that there may be certain situations where it is not necessary to obtain a summary memorandum beyond the requirements of AS 1215.19.

Multi-tier Audits

The Board is considering the following revision to AS 1201.B3:

"...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."

We are concerned about the requirement for the lead auditor to obtain, review, and retain a copy of the summary memorandum provided by the second other auditor to the first other auditor. This requirement would likely result in unnecessary duplication of effort and incremental cost without a commensurate benefit to audit quality. While we agree the lead auditor should evaluate the first other auditor's supervision of the second other auditor's work, we believe this evaluation occurs when the lead auditor obtains and reviews the information provided by the first other auditor to the lead auditor. The Supplemental Request for Comment is unclear as to how the level of activities required by the lead auditor to supervise other auditors might vary in different circumstances, and how the downstream reviews can be leveraged by the lead auditor. Although the text of the proposed amendments is explicit in allowing the lead auditor to vary the extent of supervision,⁹ requiring the lead auditor to obtain, review, and retain the summary memorandums of each other auditor in a multi-tier audit is not commensurate with a risk-based supervisory approach.

In a multi-tier audit structure, there can be very important processes and controls that occur at a regional level before "rolling up" to consolidated totals. By requiring the lead auditor to obtain, review, and retain the summary memorandum of the second other auditor, the proposed amendment introduces duplication between the activities of the lead auditor and the first other auditor. We are concerned this will have a negative effect on audit quality, because the lead auditor may decide not to use a first other auditor in order to avoid duplicative reviews (and therefore increased costs) of the second other auditor's summary memorandum. We believe it is important for the lead auditor to have the ability to rely on the first other auditor as it relates to supervising the second other auditor. For example, the first other auditor may have a unique understanding of how the information from the other entities within that region aggregate into the regional totals. The first other auditor may also have insight into the risks associated with the other entities within that region, whereas the lead auditor might not have similar insight and, as a result, a risk of material misstatement may not be identified or assessed. Additionally, there could be language barriers between the second other auditor and lead auditor as well that hinder the ability of the lead auditor to review the work of the second other auditor. In these situations, we believe it would be ineffective and inefficient to require the lead auditor to obtain, review, and retain a copy of the summary memorandum provided by the second other auditor.

⁹ AS 1201.06.

We therefore believe AS 1201.B3 should not require the lead auditor to obtain, review, and retain the summary memorandum of the second auditor, unless determined necessary by the lead auditor (e.g., due to risk or other audit matters). If the knowledge, skill, and ability of the first other auditor is not appropriately considered in determining the supervisory approach, the lead auditor may spend time that is unwarranted reviewing the work of a competent second other auditor. This may result in less time for the lead auditor to focus on higher risk areas, especially during the execution and completion phases of the audit, which could therefore have a detrimental effect on audit quality.

Therefore, we suggest the following revision to proposed AS 1201.B3:

.B3 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 subunit audited by a second other auditor. As another example, an other auditor might assist the lead auditor in supervising a second other auditor.²⁴ In these situations, the lead auditor may direct the first other auditor to perform the procedures in paragraph .B2 with respect to the second other auditor on behalf of the lead auditor, 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. To do so, the lead auditor may request information provided to the first other auditor by the second other auditor as deemed necessary. ~~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 from the first other auditor.

Further, in a multi-tier audit structure, it is unclear whether the lead auditor can delegate supervision of the requirements in AS 2101.B4 and AS 2101.B6 (understanding of independence, ethics, and qualifications) to the first other auditor. If the first other auditor is supervising the second other auditor, we believe the first other auditor is in the best position to understand independence, ethics, and qualifications of the second other auditor. Therefore, delegation by the lead auditor of such responsibilities to the first other auditor should be permissible and the standards should be modified accordingly.

III. Other Matters

Economic Impact

In its Supplemental Request for Comment, the Board states that it “has preliminarily concluded that the impact of the revisions discussed in this release relative to the 2016 Proposal would be negligible from an economic perspective – in other words, they would not significantly change the analysis set forth in the 2016 Proposal.”¹⁰ We believe the proposed amendments in the Supplemental Request for Comment will have a significant economic impact for auditors and companies as we have begun to identify in this letter. Implementation will also require significant investment in information technology solutions that will work across jurisdictions. Different firms utilize different systems today, and as such, these solutions will be complicated and expensive to develop.

¹⁰ Supplemental Request for Comment, page 42.

Effective Date

The preparation for, and the implementation of the proposed standard and proposed amendments will take a considerable amount of time, especially given the global scope and the broad changes to existing practice. Implementation will likely be even more difficult for firms that do not operate in a global network, but who audit issuers that operate in multiple jurisdictions. The amount of time firms need to prepare for the proposed standard and proposed amendments also may differ based on resources and staffing available.

Many of the changes proposed would need to be incorporated into the overall audit plan, and communicated to other auditors; therefore, implementation of the changes at the audit level will begin at the planning stage of the audit. Firm methodologies, related tools, and guidance will therefore need to be fully updated prior to the beginning of the audit year in which the revised standards become effective. Audit firms will also need to develop and implement training and effective quality control processes and procedures to support and facilitate effective implementation.

In order for firms to sufficiently prepare, we strongly recommend that the proposed standard and proposed amendments be effective for audits of fiscal years beginning no sooner than two years after approval by the SEC (or for audits of fiscal years beginning three years after the year of SEC approval if that approval occurs in the third or fourth quarter).

The CAQ appreciates the opportunity to comment on the Supplemental Request for Comment and would be pleased to discuss our comments or answer any questions that the Staff or the Board may have regarding the views expressed in this letter.

Sincerely,



Cynthia M. Fornelli
Executive Director
Center for Audit Quality

cc:

PCAOB

James R. Doty, Chairman
Lewis H. Ferguson, Board Member
Jeanette M. Franzel, Board Member
Steven B. Harris, Board Member
Martin F. Baumann, Chief Auditor and Director of Professional Standards
Keith Wilson, Deputy Chief Auditor

SEC

Jay Clayton, Chair
Michael S. Piwowar, Commissioner
Kara M. Stein, Commissioner
Wesley R. Bricker, Chief Accountant
Marc A. Panucci, Deputy Chief Accountant

IAASB

Arnold Schilder, Chairman



Key Observations from Recent CAQ Comment Letters to the PCAOB

This document summarizes certain key observations from recent CAQ comment letters submitted to the PCAOB. It should not be viewed as all inclusive, and should be read in conjunction with all CAQ comment letters applicable to the related proposals and concept releases.

I. Proposed Auditing Standard for Auditing Accounting Estimates, Including Fair Value

Measurements (Proposed Estimates Standard): In response to the PCAOB’s standard-setting project related to auditing accounting estimates, the CAQ has submitted multiple comment letters¹ to the PCAOB. Below is a summary of the comments raised in the most recent [comment letter](#) to the PCAOB on this topic.

a) Objective of the Proposed Estimates Standard

- The Proposed Estimates Standard includes the explicit objective that estimates be free from bias that results in a material misstatement. This could result in confusion regarding the extent of work intended to be performed by the auditor in accordance with the requirements of the PCAOB’s extant standards related to management bias and the requirements in the Proposed Estimates Standard.

b) Identifying and Assessing Risks of Material Misstatement

- It is not clear in the Proposed Estimates Standard that auditors would tailor their audit response to an estimate that represents a significant risk versus an estimate that represents a lower risk of material misstatement.
- We question if it improves risk identification to require the auditor to evaluate whether management’s methods are “appropriate for the nature of the related account or disclosure and the **business, industry**, and environment in which the company operates,” as facts and circumstances of a specific accounting estimate may not always be related to the issuer’s industry. Management’s processes and controls are designed to operate at a greater level of precision than the auditor’s materiality and testing thresholds. Due to this difference, it is possible that the auditor’s conclusion as to which assumptions are significant could differ from management’s. If the auditor is able to demonstrate that an assumption is not significant, the auditor should not be required to identify the assumption as significant solely because management did.

c) Valuation of Investments Based on Investee Financial Condition or Operating Results

- We have concerns with the proposed requirements in Appendix A to Auditing Standard 1105, *Audit Evidence* (AS 1105) in the Proposed Estimates Standard for situations in which the valuation of an investment is based on the investee’s financial condition or

¹ See the following CAQ comment letters submitted to the PCAOB on this topic: [Auditing Accounting Estimates Letter](#) (November 3, 2014), [Auditing Accounting Estimates and Fair Value Measurements - A Framework](#) (December 1, 2015).



operating results. The proposed requirements could significantly expand the current requirements for auditors without benefitting audit quality. For many noncontrolling investments, company management may not have direct access to investee management or may not be entitled to such information pursuant to the terms of the investment arrangement to enable the company auditor to perform the proposed procedures. There are often situations where the financial statements of investees are audited under other auditing standards. The Proposed Estimates Standard should not limit the auditor's ability to use audit reports issued in accordance with standards set by other bodies.

d) Audit Evidence

- We also raised concerns in our comment letter on the need for clarification of requirements related to third party pricing information, developing an independent expectation of the estimate, and the evaluation of contradictory audit evidence.

II. Proposed Amendments to Auditing Standards for Auditor's Use of the Work of Specialists

(Proposed Amended Specialists Standard): The CAQ has submitted a prior comment letter² to the PCAOB. Below is a summary of the comments the CAQ raised in the most recent [comment letter](#) to the PCAOB on this topic.

a) Objectivity

- We support using the term "objectivity" versus the phrase "relationship to the company" for company specialists (employed or engaged). When evaluated appropriately, a specialist's relationship to the company would be considered within the assessment of a specialist's objectivity. Evaluating the degree of objectivity of a company's specialist should be viewed as a continuum that affects the nature, timing, and extent of audit procedures.

b) Expertise

- The proposed amendments to paragraphs .B6a and .B8(3) of AS 1105 seem to suggest that the auditor would need to evaluate whether the data was "appropriately" used by the specialist. It is unclear whether this requirement is intended to be similar to paragraph .14 of the Proposed Estimates Standard. The auditor is not expected to have the expertise of a person trained for or qualified to engage in the practice of another profession or occupation and based on auditor judgment, may encounter matters that require such specialized skill. The additional proposed requirements in .B8 that "the auditor should evaluate whether the methods used by the specialists are appropriate and the significant assumptions used by the specialists are reasonable" would require an elevated level of knowledge by the auditor.

² See the following CAQ comment letter submitted to the PCAOB on this topic: [CAQ Specialists Comment Letter](#) (July 31, 2015).



c) Requirement for auditors to apply the same auditing procedures to accounting estimates regardless of whether or not management uses an external specialist

- The Note to paragraph .B8 indicates that the auditor should also comply with the requirements in paragraphs .09 - .18 of the Proposed Estimates Standard, if the company's specialist assisted the company in developing an accounting estimate. We suggest that the nature and extent of procedures should not be the same when a company employed specialist develops an accounting estimate themselves as opposed to when management uses a company-engaged specialist (i.e., an external specialist) that is competent and objective. Furthermore, certain of these procedures may not be practicable given the proprietary nature of certain specialist models or the auditor's lack of sufficient knowledge of the specialist's field to perform all the procedures in these paragraphs. We recommend keeping the principles of extant Auditing Standard 1210, *Using the Work of a Specialist* in regards to this topic.

d) Communication

- We support the requirement to "inform the specialist of the work to be performed, which includes establishing and documenting an understanding with the specialist..." The language within Staff Consultation Paper No. 2015-01: *The Auditor's Use of the Work of Specialists* (Consultation Paper), which does not appear to be included in the potential amended standard, suggests that "evidence of the agreement between the auditor and the auditor's specialist might be in the planning memorandum, separate memorandum, audit programs, or other related workpapers." We believe this provides an appropriate amount of flexibility to the auditor and should be explicitly stated within Auditing Standard 1201, *Supervision of the Audit Engagement* (AS 1201).

e) Smaller Firm Burden

- We recognize the Proposed Amended Specialists Standard, if approved, could place a significant and possibly disproportionate burden on accounting firms that do not have employed specialists on staff. The PCAOB should also consider this point as it determines the final effective date. The amount of time a firm needs to prepare for the new standard may be different based upon the resources and staffing available and some firms may need more time to prepare for implementation of the proposed changes.

III. Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Accounting Firm (Proposed Supervision of Other Auditors Standard): The CAQ has submitted a prior comment letter³ to the PCAOB. Below is a summary of the comments the CAQ raised in the most recent [comment letter](#) to the PCAOB on this topic.

³ See the following CAQ comment letter submitted to the PCAOB on this topic: [Supervision of Audits Involving Other Auditors](#) (July 29, 2016).



a) **Lead Auditor Determination**

- ...[T]here could be scenarios where no one auditor would meet the criteria [in determining the sufficiency of participation] of proposed Auditing Standard 2101, *Audit Planning* (AS 2101) paragraph .B2, such as when no individual auditor audits the risks of material misstatement associated with a larger portion of the company's financial statements. The determination of a lead auditor should take into account other qualitative considerations, such as legal and licensing requirements of certain jurisdictions.

b) **Other Auditors' Compliance with Independence and Ethics**

- We have significant concerns related to the implementation of the proposed amendment to AS 2101.B4 to gain an understanding of each other auditor's (1) process for determining compliance with the SEC independence requirements and PCAOB independence and ethics requirements and (2) experience in applying the requirements. Requiring each lead auditor at an engagement team level to gain an understanding of each other auditor's processes (even at the firm level of the other auditor) represents a significant change in existing practice, without a clear understanding of the added benefit. We do not believe such a requirement will necessarily strengthen compliance and could add significant costs. The written representation (premised on consideration of a firm's system of quality control) has an important role to play in considering the independence of the other auditor. Only when there is no such basis for reliance on the system of quality control should the lead auditor consider performing incremental procedures.

c) **Qualifications of and Communication with Other Auditors**

- The PCAOB is considering a new requirement for the lead auditor to inquire about the other auditors' policies and procedures relating to assignment and training of individuals, and gaining an understanding of the knowledge, skill, and ability of the other auditors who assist the lead auditor with planning or supervision. Inquiring about how other auditors assign individuals to audits and train individuals may not be practical for the lead auditor, as such policies and procedures may be considered confidential and proprietary in nature. Gaining an understanding of the knowledge, skill, and ability of other auditors who assist the lead auditor with planning, supervision, or review enables the lead auditor to appropriately vary the extent of supervision.

d) **Lead Auditor Communications**

- We believe communicating all identified risks of material misstatement in all cases is too broad of a requirement. We have a concern that the lead auditor may not always be in a position to identify the complete listing of risks at a location or business unit, and the other auditor should be leveraged in this regard. We suggest modifying the proposed amendments to require communication by the lead auditor of significant matters



identified from discussions with engagement team members of risks of material misstatement as required by Auditing Standard 2110, *Identifying and Assessing Risks of Material Misstatement* paragraphs .49 - .51.

e) **Review of Specified Documentation, including Summary Memorandum**

- Proposed amendment AS 1201.B2c requires the lead auditor to “[d]irect the other auditor to provide for review specified documentation with respect to the work requested to be performed....” We believe that in a risk-based approach, the determination of documentation to be reviewed is determined by multiple factors, including the professional competence of the other auditors and the risks of material misstatement addressed by their work. We request that the PCAOB clarify that there may be certain situations where it is not necessary to obtain specified documentation beyond Auditing Standard 1215, *Audit Documentation* paragraph .19 (such as if the lead auditor determines that the extent of supervision provided is sufficient and they were involved in the planning, execution, and conclusions regarding the procedures performed by the other auditor). It would be useful for the PCAOB to acknowledge that specified documentation obtained by the lead auditor may include a summary of the procedures performed.

f) **Multi-tier audits**

- We believe proposed amendment AS 1201.B3 should not require the lead auditor to obtain, review, and retain the summary memorandum of the second other auditor, unless determined necessary by the lead auditor (e.g., due to risk or other audit matters). If the knowledge, skill, and ability of the first other auditor is not appropriately considered in determining the supervisory approach, the lead auditor may spend time that is unwarranted reviewing the work of a competent second other auditor.



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November 15, 2017

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 042
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

Dear Office of the Secretary:

Crowe Horwath LLP appreciates the opportunity to comment on the Public Company Accounting Oversight Board's Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Accounting Firm.

We support the Board's effort to improve audit quality by enhancing an existing standard that has been part of audit standards since the 1970's. We also agree with the Board's decision to provide a new specific standard for when the auditor divides responsibility for an audit with another accounting firm. We are pleased to provide our observations regarding areas where we believe the Proposed Amendments or the Proposed Standard could be modified to provide clarity for the auditor as well as observations related to risk-based concepts.

Our observations are cross-referenced to specific paragraph language within the Proposed Amendments or Proposed Standard.

AS 2101 – *Audit Planning*, Appendix B - "Other Auditors' Compliance with Independence and Ethics": we acknowledge that compliance with independence and ethics are key elements of an audit and key reasons the public has trust in the work that auditors perform. The way in which Paragraph B4 is written, it applies to *all* other auditors utilized, without scalability. We believe scalability can be achieved without jeopardizing independence, ethics or public trust. Paragraph B4a should be written to be scalable between other auditors who are registered with and subject to inspection by the PCAOB and other auditors who are not periodically inspected by the PCAOB. If a firm is using another auditor that is registered with the PCAOB and inspected by the PCAOB at least triennially, including their independence processes and quality control systems, then paragraph B4a should be optional for the lead auditor. Our recommendation for scalability is rooted in our anticipated audit response to another element of the standard on *Audit Planning*. As a response to paragraph AS 2101, B6.b.2 regarding the qualifications of other auditors, the lead auditor may obtain the other auditors' most recent PCAOB inspection report. Based on evaluation of that inspection report and procedures performed in response to paragraph B4b, the lead auditor should determine if additional understanding of the other auditors' independence and ethics processes is warranted. Thereby, paragraph B4a would be required only for other auditors not subject to inspection by the PCAOB and would be optional based on risk, when other auditors are registered with and subject to inspection by the PCAOB.

Office of the Secretary
Public Company Accounting Oversight Board
November 15, 2017
Page 2

As noted above, we also believe the requirements within paragraph B6 regarding “Qualifications of and Communication with Other Auditors” should be scalable based on whether or not the other auditor is registered with and subject to inspection by the PCAOB. Specifically, paragraph B6a, steps 1 and 2 should be required for other auditors who are not registered with the PCAOB and optional based on risk, for other auditors that are registered with and subject to inspection by the PCAOB. We believe that this scalability does not negatively affect audit quality and that it supports a risk-based approach to understanding other auditors’ qualifications.

AS 1206, Appendix B, Paragraph B1, *Example 1* provides language to be used when the lead auditor audits the conversion adjustments, 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. The last sentence in this example paragraph indicates the following: “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.” As noted, the PCAOB clearly wants the users to understand which firm audited the conversion adjustments when different financial frameworks are used. However, this example report also refers to the audit of internal control over financial reporting. We believe the sentence noted above should also be modified, or that another sentence should be added, to identify which firm audited the internal controls over the conversion adjustments to the financial statements, in order to be fully transparent to the users.

Lead audit firms will need to develop and implement training and effective quality control processes in order to implement these proposed amendments and the new proposed standard. In order for firms to appropriately execute these changes within networks as well as enhance communications with other auditors outside of their network, we believe lead audit firms need at least 24 months to implement the new requirements, from the date the SEC approves the changes.

Crowe Horwath LLP supports the PCAOB’s efforts to improve public company auditing standards and the due process to ensure proposed standards result in such improvements, mindful of cost benefit considerations and avoidance of unintended consequences. We would be pleased to respond to any questions regarding our observations noted within this letter. This is a complex subject and if there are any other questions regarding this subject, please contact Michael G. Yates at (574) 236-7644.

Sincerely,

Crowe Horwath LLP

Crowe Horwath LLP



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November 15, 2017

Office of the Secretary
Public Company Accounting Oversight Board 1
666 K Street, N.W.
Washington, D.C. 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 042

Deloitte & Touche LLP (“D&T”) is pleased to respond to the request for comments from the Public Company Accounting Oversight Board (the “PCAOB” or the “Board”) on PCAOB Release No. 2017-005, *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* (collectively, “the 2017 Proposal” or “the 2017 Release”), which addresses certain revisions to PCAOB Release No. 2016-002, *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard — Dividing Responsibility for the Audit with Another Accounting Firm*, from April 12, 2016 (collectively, “the 2016 Release”), as well as other matters related to audits that involve accounting firms and individual accountants outside the accounting firm that issues the audit report.

Overall Comments

We support the Board’s efforts to enhance the standards of the PCAOB that address audits involving accounting firms and individual accountants outside the accounting firm that issues the auditor’s report and to align the applicable requirements with the PCAOB’s risk-based standards. These situations are becoming more and more prevalent as companies continue to expand their presence throughout this world. Similar to our response to request for comment on the 2016 Release, while we are supportive of the objectives of the Board, we have certain constructive suggestions. Specifically, we note that certain of the practical implementation challenges identified in our response to the 2016 Release (see Appendix B, *Deloitte & Touche LLP’s Response to the 2016 Release*) still exist, including:

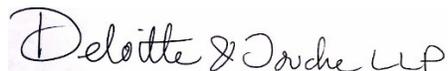
- The ability to implement the limited criteria to serve as lead auditor in certain situations. Based on the group entity structure and domicile, as well as jurisdictional regulations related to auditor licensing, we believe there will be instances in which it would be difficult for any accounting firm to serve as the lead auditor, which creates a public interest challenge of having an audit performed.
- Expanded requirements related to the lead auditor obtaining an understanding of the other auditors’ independence and ethics, as well as policies and procedures related to training and assignment of individuals to audits. The practical challenges of implementation pose a very real risk for effective implementation of the requirements. Our experience suggests that centralization of such monitoring activities enhances audit quality both within an audit and within a firm.

In Appendix A, we offer further observations related to these matters, as well as responses to the questions posed in the 2017 Release. Our observations are made in light of the goal of having a final standard that clarifies the lead auditor’s responsibilities with respect to other auditors, including providing additional direction to the lead auditor on how to apply the principles-based supervisory requirements of the standards.

* * *

D&T appreciates the opportunity to provide our perspectives on these important topics. The potential benefits of the Proposal are significant and, while some of these considerations are complex and challenging, we do not believe any of these should stand in the way of completing this important project. We stand ready to engage constructively with the Board and other stakeholders to provide our perspective and experiences in order to facilitate the development of improvements to the PCAOB's auditing standards that will enhance audit quality. If you have any questions or would like to discuss these issues further, please contact Dave Sullivan at 714-436-7788 or Megan Zietsman at 203-761-3142.

Very truly yours,

A handwritten signature in cursive script that reads "Deloitte & Touche LLP". The signature is written in black ink on a white background.

Deloitte & Touche LLP

cc: James R. Doty, PCAOB Chairman
Lewis H. Ferguson, PCAOB Member
Jeannette M. Franzel, PCAOB Member
Steven B. Harris, PCAOB Member
Martin F. Baumann, PCAOB Chief Auditor and Director of Professional Standards
Keith Wilson, PCAOB Deputy Chief Auditor

Jay Clayton, SEC Chairman
Kara M. Stein, SEC Commissioner
Michael S. Piwowar, SEC Commissioner
Wesley R. Bricker, Chief Accountant
Marc A. Panucci, Deputy Chief Accountant
Russell G. Golden, FASB Chairman

APPENDIX A — RESPONSE TO QUESTIONS POSED IN THE 2017 RELEASE

Question 1: Is the revised requirement for determining the sufficiency of participation to serve as lead auditor, based on risk and importance of the locations, appropriate and clear?

We agree that risk and importance of the locations are appropriate criteria for determining sufficiency of participation to serve as lead auditor; however, we believe that there are other criteria that are also appropriate to consider. We therefore recommend that the 2017 Proposal acknowledge and include additional guidance for situations in which risk and importance of the locations may not both lead to the same conclusion about the determination of the lead auditor, and other situations in which conflict with auditor licensing requirements may exist based on the domicile of the entity. For example, there are situations in which the entity is domiciled in a location in which the primary financial reporting decisions may not be made, but based on laws and regulations, an accounting firm in the location of domicile is required to perform the audit (see Appendix B, pages 17-20, for further discussion on this topic). In addition, certain guidance helpful to group audit execution that is in the existing standard today has been removed, which may create practical challenges in determining the lead auditor (e.g., AS 1205.02-06).

We acknowledge that the Board has proposed edits and additional consideration regarding AS 2101.B2 in the 2017 Release. However, we believe some additional changes are needed in the area of determining sufficiency of participation to serve as lead auditor, with specific clarity needed in the following areas:

- Page 9 of the 2017 Release states:

Including importance as an additional consideration would more expressly address circumstances where, for example, the lead auditor audits the locations or business units where the primary financial reporting decisions are made and consolidated financial statements are prepared, even though they might not comprise a significant portion of the company's operations. Notably, the importance consideration is similar to an existing factor in AS 1205.

As it is currently worded, the requirements in the 2017 Proposal does not appear to fully acknowledge situations in which the lead auditor does not audit a significant portion of the company's operations (including situations in which there may be no other auditor that audits more than the lead auditor). We believe the proposed standard should provide explicit wording that the lead auditor determination is based on specific qualitative factors as well, including where the primary financial reporting decisions are made and the consolidated financial statements are prepared. The 2017 Release also points to a similar existing factor in AS 1205.02, which states:

The auditor considering whether he may serve as principal auditor may have performed all but a relatively minor portion of the work, or significant parts of the audit may have been performed by other auditors. In the latter case, he must decide whether his own participation is sufficient to enable him to serve as the principal auditor... In deciding this question, the auditor should consider, among other things, the materiality of the portion of the financial statements he has audited in comparison with the portion audited by other auditors, the extent of his knowledge of the overall financial statements, and the importance of the components he audited in relation to the enterprise as a whole.

AS 1205.02 therefore explicitly acknowledges there can be circumstances in which the other auditors perform a major portion of the work and where the lead auditor's participation in the other auditors' work is sufficient based on the extent of his knowledge of the overall financial statements, among other things. As this standard is to be superseded in part by AS 2101.B2,

we believe the proposed wording for the revised standard should acknowledge that specific qualitative factors can potentially outweigh quantitative factors when determining the lead auditor.

- We note that page A4-15 of the 2016 Release states:

The proposed risk-based criterion is intended to capture both quantitative as well as qualitative characteristics of a particular scenario. Under this criterion, the lead auditor ordinarily would need to audit the location at which the primary financial reporting decisions were made and the consolidated financial statements were prepared in order to address the risks related to those important judgments and activities, and a sufficient number of other locations to cover a greater portion of the risks than any of the other audit firms performing procedures on the audit.

If there is an expectation that the lead auditor performs procedures on a greater portion of risks than other auditors, we believe it is not sufficiently clear how, considerations related to “importance” (as described in AS 2101.B2.b) should be taken into account in determining sufficiency of participation.

- AS 2101.B2a identifies the portion of the risks of material misstatement associated with the company’s financial statements for which the lead auditor performs audit procedures as a criteria for determining lead auditor. The 2017 Release also provides for taking into account the importance of a location or business unit, as well as qualitative and quantitative factors, when determining lead auditor (AS 2101.B2b); however, a framework for how to “take into account the importance” has not been included in the proposed standard. We note that in identifying and assessing the risks of material misstatement in a multi-location audit, the auditor is required to consider the factors in AS 2101.12. As we believe these factors already result in the auditor taking into account the “importance” of the locations or business units for which the lead auditor is performing procedures, the incremental effort that would be expected to “take into account importance,” as instructed in AS 2101.B2b, is not apparent.
- Page 11 of the 2017 Release states,

...the sufficiency determination should be based on the work the auditor performed on the audit, rather than on the auditor's attributes... the Board does not currently intend to change the requirement so that close supervision of other auditors' work by the lead auditor would count toward the lead auditor's participation.

We expressly believe the work that the lead auditor performs on the audit includes supervision of other auditors, and therefore, sufficiency should include the factors from AS 1201.06. Appropriate recognition of these qualitative factors is necessary, as they are critical in determining the sufficiency of the lead auditor’s participation. We therefore suggest the Board re-consider the direction of this requirement, as we believe focusing only on the quantitative metric of “coverage” of performing audit procedures that address risks may result in the inability for any registered accounting firm to meet the lead auditor definition and requirements to serve as such.

As noted in the bullets above, we believe additional criteria should be considered in identifying the lead auditor and in developing a risk-based framework for supervision of other auditors by the lead auditor and engagement team. In addition, if a shared system of quality control at the network level exists and is operating effectively, we believe reliance by the lead auditor on such commonalities should influence the nature, timing, and extent of direction and supervision of other auditors from the same network and subject to the same system of quality control. A shared system of quality control, when operating effectively, provides shared methodologies, a common “language” and understanding,

and distinguishes use of other auditors from within such a network from other auditors outside of the network. We believe the standard should clearly recognize this distinction as part of its risk-based, scalable approach to direction and supervision.

Question 2: Is the additional sufficiency threshold for divided responsibility engagements clear? Should this be a bright-line requirement, or does this threshold need to allow for exceptional situations? Are there any other implications of this threshold that the Board should consider, such as investor protection implications or auditing challenges related to the revised requirement?

We believe that the additional sufficiency threshold for divided responsibility engagements is clear. The threshold for divided responsibility engagements discussed in AS 2101.B2 of the 2017 Release should not be a bright-line requirement, as there are diverse, complex, and unique situations for which a bright line will not be feasible.

Question 3: Are the revised requirements relating to the other auditors' compliance with the independence and ethics requirements appropriate? Are there any practical challenges associated with the revised amendments? If so, what are they, and how could the proposed requirements be revised to address the challenges?

We believe that multiple implementation challenges may arise in relation to the revised requirements relating to the other auditors' compliance with independence and ethics requirements, including challenges related to confidentiality and access, the ability to consider the effectiveness of firm network level controls and policies, and the lead auditor's ability to execute the requirements.

We believe that the lead auditor should perform procedures to support the determination that the other auditor is in compliance with SEC independence requirements as well as PCAOB independence and ethics requirements (the "independence and ethics requirements"). We acknowledge that it is also imperative for other auditors to have a process for determining compliance, in order that other auditors can represent appropriate compliance with independence and ethics requirements to the lead auditor. However, we have the following observations related to the revisions to the requirements in AS 2101.B4:

- Depending on the circumstances, determining whether an individual or firm is independent may be a complicated activity, which often involves individuals with deep expertise and experience in this area. Some accounting firms and accounting networks have invested in and established robust processes and activities as part of their firm-wide system of quality controls to provide reasonable assurance that the firm and its employees are appropriately independent. While audit professionals need to understand the independence and ethical requirements that are applicable, reliance on the specialized individuals in a firm may be necessary to determine compliance with such requirements. As discussed on page 12 of the 2017 Release, the proposed standard was updated to require the lead auditor to understand the other auditor's process for determining compliance as "the lead auditor would be in a better position to identify matters that may warrant further attention." However, we do not believe that the lead auditor is necessarily in the best position (and may not possess the specialized skill) to evaluate the other auditor's process for compliance with independence and ethics requirements in order to identify matters that may warrant further attention, due to the specialized skill that this may require.
- There are also a variety of practical issues and real barriers that will cause difficulties relative to lead auditors obtaining access to information related to an other auditor's process to determine compliance with independence and ethics requirements, including issues related to legal protection over confidential and proprietary information (e.g., there may be limitations on the level of detailed information that accounting firms will provide related to their policies and procedures, particularly if the lead auditor is from another firm that is not part of the

other auditor's network). We recognize that the 2016 and 2017 Releases do not prescribe specific procedures for how the lead auditor should gain an understanding of the other auditor's processes for determining compliance with the requirements; however, we note that the 2016 and 2017 Releases refer to a variety of different types of information that the lead auditor may obtain from an other auditor to determine knowledge of independence and ethics requirements (see pages A4-22 and 23 of the 2016 Release, and pages 12 through 14 of the 2017 Release). However, as stated above, the lead auditor may not have access to some or many of these types of information, and accordingly, it would be difficult for the lead auditor to apply the factors described in the release that may affect the necessary level of effort in obtaining the understanding of the other auditor's process and experience.

- We acknowledge that page 13 of the 2017 Release notes certain:

...factors that may affect the necessary level of effort in obtaining the understanding of the other auditor's process and experience include the lead auditor's existing knowledge of the other auditor's process; the lead auditor's experience with the other auditor's past compliance with the ethics and independence requirements; changes in the other auditor's processes or circumstances that may affect the risk of non-compliance; and other information available to the auditor about the other auditor's practices or compliance with independence and ethics requirements.

However, if the lead auditor is not privy to this information about the other auditor (which may be confidential), these factors do not actually allow for judgment in the level of effort necessary.

- We observe that the Board has set forth its conclusion to preclude reliance on network-level policies and procedures in determining the other auditor's compliance with independence and ethics requirements (as stated on page 14 of the 2017 Release). It is the responsibility of each audit firm to maintain systems and processes to comply with the independence and ethics requirements. However, we note that in current practice, auditors use firm and network-level processes as the basis for making independence representations as required by AS 1205.10b. We continue to believe that other auditors should be able to rely on a shared system of quality control at the network level, when found to be operating effectively and applicable, to address the consideration of compliance by in-network other auditors with independence and ethics requirements. In addition, we believe a risk-based approach should be used to determine whether to obtain any additional understanding beyond the written representation obtained from the other auditor. This approach would allow for auditor judgment to be applied and for the auditor's effort to be focused on the circumstances in which additional information is important to judgments about the other auditor's compliance with the requirements or where contradictory evidence with respect to the other auditors' independence may present itself.

Based on these considerations, we recommend that AS 2101.B4 be modified to reflect these views. Furthermore, notwithstanding the suggestions we've noted, we believe the PCAOB standards should acknowledge that some of the independence and ethics requirements might be addressed by the lead auditor's firm on behalf of multiple engagement teams (e.g., so that the same information does not have to be provided multiple times to lead auditors within the same firm).

Question 4: Are the proposed amendments relating to the knowledge, skill, and ability of the other auditor, revised by this release, appropriate? Are there any practical challenges associated with the revised amendments? If so, what are they, and how could the proposed requirements be modified to address the challenges?

Existing requirements (e.g., 1201.06) currently require the engagement partner to determine the extent of supervision necessary for engagement team members by taking into account their

knowledge, skill, and ability. We believe this requirement is appropriate and necessary, as understanding the professional competence of the engagement team, which will include other auditors, is essential in determining the necessary supervisory activities. Furthermore, we discussed the importance of understanding the other auditor's professional competence and experience in our response to the 2016 Release (see Appendix B, page 20,).

As part of the 2017 Release, the following requirement was added to AS 2101.B6:

At the beginning of an audit that involves other auditors, the lead auditor should:

a. Inquire about other auditors' policies and procedures relating to the:

(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;

If the lead auditor has the appropriate understanding of the other auditor's professional competence as currently required, it is not however clear to us as to why the items in AS 2101.B6 are also necessary (e.g., if the lead auditor has appropriately determined that the other auditor is professionally competent, how does understanding how a firm assigns individuals to audits further the lead auditor's understanding of the other auditors' professional competence?). In addition, similar to what we noted in question 4, we believe there are real and practical issues about the ability of the lead auditor to obtain the kind of information referred to in AS 1201.B6a from other auditors (e.g., limitations may exist on the ability of firms to share proprietary or confidential information).

In situations in which the lead auditor's firm is affiliated with the other auditor's firm, the lead auditor should also be able to use the information obtained from its firm network as part of the basis for understanding the professional competence of the other auditor. It would be inefficient for the lead auditor to be expected to perform procedures to understand the knowledge, skill, and ability of an other auditor without any consideration of appropriately designed network activities that would assist in providing this information. And similarly to the observations set forth in our response to question 3 we believe that if the requirements in AS 1201.B6a are retained, the PCAOB standards should acknowledge that the understanding of these requirements might be addressed by the lead auditor's firm on behalf of multiple engagement teams (e.g., so that the same information does not have to be provided multiple times to lead auditors within the same firm).

Question 5: Are the proposed new addition to AS 1015 and revision to AS 1201 relating to the other auditors' responsibility appropriate and clear? Is it clear that AS 1015 already applies to referred-to auditors that perform audits under PCAOB standards?

We believe the revisions to AS 1201 require additional clarity to achieve the Board's objective of a risk-based approach to an audit. As stated on page 17 of the 2017 Release (bold added for emphasis):

*The proposed requirements for the lead auditor's supervision of the work of other auditors are designed to be scalable based on risk and other factors. Under the 2016 Proposal, **the engagement partner and others who assist the engagement partner in supervising the audit should determine the necessary extent of supervision**, based on the risks of material misstatement to the company's financial statements and the knowledge, skill, and ability of the other auditor, among other things."*

As emphasized in bold text in the paragraph above, we agree that the extent of supervision performed by the engagement partner and others who assist should be guided by a scalable risk-based approach. However, based on other comments in the 2017 Release (see Section B of the 2017 Release,

Supervision of Other Auditors, pages 16 through 24) and the related proposed amendments, we believe further clarification is needed, as follows:

- AS 1201.B2a(2) states

In supervising the work of other auditors, the lead auditor should: ...inform the other auditor of the following in writing...Tolerable misstatement, the identified risks of material misstatement, and if determined, the amount below which misstatements are clearly trivial and do not need to be accumulated relevant to the work requested to be performed.

This paragraph also has footnote 20 attached, which references to AS 2110.49-51 related to engagement team discussions regarding risks of material misstatement. We believe additional clarity is needed as to how to interpret and apply the requirement that the lead auditor inform the other auditor of the identified risks of material misstatement relevant to the work requested to be performed, because:

- The attachment of footnote 20 implies that this requirement is in the context of engagement team discussions. The requirements of AS 2110 do not however require that these engagement team discussions encompass all identified risks of material misstatement, and in practice, they are more likely to focus on those risks of material misstatement of greater significance, and in the context of multi-location audits, those that are likely to be most important to the work that may need to be performed by the other auditor.
- In some cases, the other auditor may be in a more appropriate position to identify and assess certain risks of material misstatement specific to the scope assigned to them, due to their knowledge, skills, and ability. We acknowledge that page 17 and 18 of the 2017 Release states that:

...some commenters raised questions as to whether the lead auditor is the auditor best suited in all circumstances to assess risks of material misstatement at locations or business units audited by other auditors... Any risks not identified by the lead auditor in its initial communication to the other auditor would be covered by an existing provision in AS 1201 to instruct the other auditors to bring any significant auditing issues, including any additional risks of material misstatement identified by the other auditor, to the attention of the engagement partner or other team members who perform supervisory activities.

While we believe the additional explanation in the release acknowledges that the standards should allow for two-way communication between the lead auditor and other auditor of the risks of material misstatement related to the other auditor's work, the wording in AS 1201.B2a(2) is more likely to drive a different conclusion (i.e., a one-way communication from the lead auditor to the other auditor of the risks of material misstatement).

- As noted in our firm's response to the 2016 Release, we believe that the requirement in AS 1201.B2b related to the lead auditor communicating in writing to the other auditor about any changes that need to be made to the other auditor's description of the audit procedures is too prescriptive, especially as some matters might be more easily and effectively dealt with through verbal communications. We also believe the requirement should support more flexibility and a collaborative approach. We therefore believe that the proposed standard should provide for lead auditors being able to use professional judgment in determining how to communicate changes and also about the necessary supporting documentation (see Appendix B, pages 25 and 26, for additional discussion).
- In regard to AS 1201.B2d, pages 18 and 19 of the 2017 Release state:

The 2016 Proposal includes a new requirement in the standard on supervision according to which the lead auditor should obtain from the other auditor a written report describing the other auditor's procedures, findings, conclusions, and if applicable, opinion. The proposed requirement was intended to require the other auditor to make a written statement, and to inform the lead auditor, about the work for which the other auditor was responsible and the results of that work... The required content of the report would remain the same as originally proposed – a description of the other auditor's procedures, findings, conclusions, and, if applicable, opinion, in sufficient detail for the necessary level of supervision. To distinguish more clearly non-public communications between other auditors and the lead auditor (internal communication between two parties) from audit reports issued for general public use, the Board is considering a revision that would replace "written report" with "summary memorandum" in the proposed amendments to AS 1201... As revised, this requirement to obtain a summary memorandum from the other auditor would be generally consistent with existing auditing practice.

We believe that additional clarity is needed to address what is required to be included as part of the "summary memorandum" as described in AS 1201.B2d and the required documentation related to the work performed by other auditors in AS 1215.19, which includes a "completion document consistent with paragraphs .12 and .13." As a "completion document" can be (and typically is) interpreted to also include a list of the other auditor's procedures, findings, and conclusions (among other things), it is therefore not clear to us whether these two documentation items are intended to be different or whether they overlap with one another.

Question 6: Are the proposed new additions to AS 2101.B2 appropriate and clear? Also, is it clear that the necessary level of detail of the other auditor's audit documentation that the lead auditor obtains and the necessary extent of the lead auditor's review according to requirements in proposed Appendix B of AS 1201 are scalable based on the factors in the existing standard regarding the necessary extent of supervision?

As noted in our response to question 5, we support a scalable, risk-based approach to supervision by the engagement partner and others who assist the engagement partner; we believe the addition of the two notes to paragraph AS 2101.B2 are appropriate and also support a risk-based scalable approach. We don't believe that, in all cases, the lead auditor needs to review additional audit documentation of the other auditor, *in excess of* that which is already required to be reviewed by AS 1215.19. Rather, we believe that the determination of whether documentation in excess of that which is already required to be reviewed (including the documentation required to be reviewed in AS 2101.B2b, AS 2101.B2d, and AS 1215.19) is determined by multiple factors, including:

- The experience the lead auditor has with working with the other auditor and the resulting understanding of their knowledge, education, and skills.
- The results of internal practice reviews (if within the same network), other inspection results, and their relevance to the other auditor's work.
- The complexity and nature of judgments related to the procedures that the lead auditor has requested the other auditor to perform, including whether the other auditor is responsible for performing procedures related to significant risks.
- If in place and effective, a shared system of quality control for network firms.
- The business and cultural environment in which the other auditor operates.
- The factors described in current AS 1201.06.

- The results of review of the other auditor’s audit documentation.

Therefore, as it relates to AS 2101.B2c, we recommend that the paragraph be modified to embrace the risk-based approach desired by the Board, as follows (additions are noted in **bold underline**): “Direct the other auditor to provide for review specified documentation with respect to the work requested to be performed, **as necessary.**”

Question 7: Are the revised proposed requirements for situations in which the lead auditor directs an other auditor to perform supervisory procedures with respect to a second other auditor on behalf of the lead auditor clear? If not, how should the revised proposed requirements be revised?

We recommend that AS 1201.B3 be modified to appropriately take into account the lead auditor’s decisions on what constitutes appropriate audit evidence based on the facts and circumstances, and structure of the entity that is being audited. We believe it is appropriate for the lead auditor to consider how the company’s financial information is consolidated in order to determine how to obtain sufficient appropriate audit evidence and how the audit documentation is best maintained. We note that AS 1201.B3 discusses the situation in which 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. When the financial information that the second other auditor is auditing is included in the financial information of the first other auditor, the first other auditor’s communications to the lead auditor (e.g., the summary memorandum required by AS 1201.B2d or the communications required by AS 1215.19) include, as necessary, the results of procedures performed by the second other auditor. Therefore, requiring that the second other auditor provide to the lead auditor the communications noted in AS 1201.B2d and AS 1215.19 would be duplicative of communications that already occur between the lead auditor and the first other auditor.

Furthermore, in the situation noted in the preceding paragraph, when the lead auditor uses a first other auditor, they do so with the knowledge and understanding that the first other auditor is capable of performing requested supervisory duties. If the lead auditor has appropriately assessed the skills and competence of the first other auditor and the first other auditor is performing the procedures in paragraph AS 1201.B2a in relation to the second other auditor, there is therefore no need for the first other auditor to provide to the lead auditor the communication described in AS 1201.B2a in relation to the second other auditor. The granular nature of requirements in AS 1201.B3 may result in the lead auditor not using a first other auditor to help supervise (e.g., then the first other auditor speaks the same language as the second other auditor, which is different than the language of the lead auditor), and we believe that this may in some cases be to the detriment of audit quality rather than enhancing it.

We also believe that in situations in which the lead auditor uses a first other auditor to help supervise a second other auditor, it is unclear as to whether the requirements in AS 2101.B4 and AS 2101.B6 (related to understanding the other auditor’s compliance with independence and ethics, as well as their professional competence) need to be performed by the lead auditor, or whether the first other auditor can perform these requirements as part of their supervisory activities. We believe that performing supervisory activities may include understanding an other auditor’s compliance with independence and ethics, as well as their professional competence. We recommend the 2017 Proposal be revised to clarify the supervisory activities performed by an other auditor (e.g., a first other auditor) may include understanding an other auditor’s (e.g., a second other auditor) compliance with independence and ethics, as well as their professional competence.

Question 8: Is the revision to the proposed standard relating to the division of responsibility when the company and its business unit use different reporting frameworks appropriate and clear?

Yes, we believe the revision to the proposed standard relating to the division of responsibility when the company and its business unit use different reporting frameworks is appropriate and clear. While we have no further comments specific to question 8, we have the following suggestions from our response to the 2016 Release that we believe should be reconsidered:

- On page 28 of our 2016 response (see Appendix B), we recommended the following change to AS 1206.08(c) (additions in **bold**, deletions are ~~struck through~~):

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, **or** ~~and~~ other appropriate criteria necessary to identify the portion of the company's financial statements audited by the referred-to auditor.

We believe this edit is important as it provides the necessary flexibility as to the criteria that are used and referred to in the auditor's report. The existing use of "and" implies that the criteria used and referred to always includes total assets and total revenues and other appropriate criteria; however this is not always the case. Furthermore, we note that Section 4140.3 of the SEC's Financial Reporting Manual (FRM) only requires that the principal auditor's report "...indicate clearly the division of responsibility between the principal auditor and the other auditor....," and does not state the criteria that must be considered or referred to. We therefore request the Board to re-consider the need for this suggested edit.

- On pages 23-24 of our 2016 response (see Appendix B), we provided our views on the principles underlying division of responsibility. We further noted that the 2016 Proposal contained requirements that go beyond current practice and may result in more opacity around the responsibility and activities the lead auditor is required to undertake with respect to the referred-to auditor, as well as the purpose of such activities. For example, the 2016 Proposal (AS 2101.14) requires that the lead auditor have discussions with the referred-to auditor to identify and assess risks of material misstatement associated with the location. As another example, AS 2401.53 of the 2016 Proposal requires that the lead auditor discuss with the referred-to auditor the extent of work that needs to be performed to address certain fraud risks. This greater level of involvement by the lead auditor in the work of the referred-to auditor diminishes the "clear line" with respect to responsibility of the lead auditor and the referred-to auditor (see Appendix B, page 24, for additional discussion).

We note that the Board has responded to this comment in the 2017 Release (page 28) by referencing *consistency* with the following existing requirement in AS 1205.10, which states:

...He also should adopt appropriate measures to assure the coordination of his activities with those of the other auditor in order to achieve a proper review of matters affecting the consolidating or combining of accounts in the financial statements....

We respectfully submit our view that the changes to AS 2101.14 and AS 2401.53 are not consistent with the existing AS 1205.10. We therefore reiterate our recommendation that the reference to referred-to auditors in AS 2101.14 and 2401.53 be removed.

- As noted in our response to the 2016 Release, it is unclear as to why in situations in which the lead auditor is unable to divide responsibility with another accounting firm, the lead auditor's performance requirements are limited only to the three options presented in AS 1206.7. We believe that another alternative is to allow for the lead auditor to identify a different other auditor and appropriately apply the requirements of the 2017 Proposal when using an other auditor. Therefore, we recommend that this additional alternative be included in AS 1206.7.

Question 9: Is it clear how the proposed amendments and new standard (as revised by this release) relate to other amendments to auditing standards proposed or adopted by the Board since the 2016 Proposal?

We believe additional clarity is needed as to how the requirements in the PCAOB's *Proposed Auditing Standard — Auditing Accounting Estimates, Including Fair Value Measurements* and proposed amendments to PCAOB auditing standards (collectively, "the Estimates Proposal"), fit with the requirements in the 2017 Release. Deloitte & Touche LLP's June 2017 response to the Estimates Proposal commented on how we did not believe that changes to standards related to investments valued based on the investee's financial condition or operating results should be done in isolation, as in many cases, the audit evidence obtained for such type of investments involves using an other auditor. Therefore, we believe that the PCAOB should address requirements related to being involved in an other auditor's work related to investments valued based on the investee's financial condition or operating results, in tandem with the 2017 Release, i.e., in order to put into context how the requirements in the Estimates Proposal fit into the requirements in the 2017 Release.

Question 10: Comment is requested on the matters discussed in this section. Would any revisions the Board is considering for adoption affect the scalability of PCAOB standards in this area? Would any have a significant effect on the competitiveness of smaller audit firms? Would the revisions significantly change the costs and benefits associated with the proposed changes discussed in the 2016 Proposal? Are there any unintended consequences that the Board should consider? Are there any other matters not addressed in this release the Board should consider in its economic analysis?

Related to the additional requirements for the lead auditor in the 2017 Release, we have the following observations:

- **Understanding each other auditor's process for determining compliance with the independence and ethics requirements.** AS 2101.B4 in the 2016 Proposal required that the lead auditor gain an understanding of each other auditor's knowledge of the independence and ethics requirements (which we believe could be accomplished by obtaining an appropriate representation, potentially supplemented with discussion or inquiry of the other auditor); the 2017 Proposal modifies this paragraph, and requires that the lead auditor gain an understanding of each other auditor's process for determining compliance with the independence and ethics requirements. This understanding is then used to evaluate such process, and identify gaps, with the goal of identifying items that will inform the lead auditor as to whether the other auditor's representation is reliable. We believe that there is a substantive difference between these two requirements.
- **Inquiring about the other auditor's policies and procedures relating to assignment of individuals to an audit and training of individuals performing PCAOB audits.** As noted in question 4, the 2017 Release included a new requirement related to the lead auditor inquiring of the other auditor's policies and procedures related to the (1) assignment of individuals to audits conducted under PCAOB standards and (2) training of individuals who perform procedures on audits conducted under PCAOB standards. The 2017 Proposal explains that this understanding is used to assist the lead auditor with identifying matters that warrant further consideration related to the professional competence of other auditors.
- **Multi-tiered audit engagements.** As described in the 2017 Proposal, and as commented on in question 7, the requirements related to the audit documentation that the lead auditor needs to obtain related to a "second other auditor" may result in an administrative burden that may not have the commensurate benefit to audit quality..

In relation to these items, we respectfully submit our view that these changes in requirements will potentially result in more effort, work, and cost. As noted in our response to questions 3 and 4, we also have questions about the ability to obtain the necessary level of information to address some of these revised requirements.

Other Matters

In regards to the effective date considered by the Board, page 44 of the 2017 Release states:

Specifically, the Board is considering whether compliance with an adopted standard and amendments should be required for audits of fiscal years beginning in the year 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).

We strongly recommend an effective date for audits with fiscal years beginning two years after the approval by the SEC (regardless of which quarter that approval occurs). Even if the SEC adopts the standard and amendments in the first quarter of calendar year 2018, we believe that public accounting firms will need over one year to determine the full impacts of the approved adopted standard and amendments, implement new policies and guidance, develop and facilitate related trainings, and coordinate quality control processes with the firm network, other auditors, and referred-to auditors in order to ensure effective implementation and compliance. Furthermore, we believe that firms that perform a large number of multinational audits will likely need to make significant investments in technology systems to support compliance with the requirements in the 2017 Proposal (including consideration of IT solutions that will work across different jurisdictions or countries); we base this belief, in part, on our experiences with designing a technology solution to support the implementation of Form AP, which involved significant time and effort but was not as complex or multifaceted as what implementation of the 2017 Proposal is likely to be.

APPENDIX B — DELOITTE & TOUCHE LLP's RESPONSE TO THE 2016 RELEASE

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July 28, 2016

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Public Company Accounting Oversight Board
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Washington, D.C. 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 042

Deloitte & Touche LLP ("D&T" or "we") is pleased to respond to the request for comments from the Public Company Accounting Oversight Board (the "PCAOB" or the "Board") on its *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors* (the "Proposed Amendments") and the *Proposed Auditing Standard — Dividing Responsibility for the Audit with Another Accounting Firm* (the "Proposed Auditing Standard") (collectively, "the Proposal" or "the Release") which addresses potential changes to the PCAOB's auditing standards for audits that involve accounting firms and individual accountants outside the accounting firm that issues the audit report.

Overall Comments

We support the Board's efforts to enhance the standards of the PCAOB that address audits involving accounting firms and individual accountants outside the accounting firm that issues the auditor's report and to align the applicable requirements with the PCAOB's risk-based standards.

The Proposal represents a significant step forward in providing a risk-based supervisory model that can be used when performing audits that involve other auditors. We are supportive of the objectives of the Board's Proposal, and offer certain constructive suggestions in this letter that are geared toward ensuring that the final standards clarify the lead auditor's responsibilities with respect to other auditors, including providing additional direction to the lead auditor on how to apply the principles-based supervisory requirements of the standards in order to:

- Increase the uniformity, consistency, and effectiveness of the lead auditor's supervision of other auditors, including through application of PCAOB Auditing Standard 1201, *Supervision of the Audit Engagement* (AS 1201), to other auditors.
- Facilitate improvements in the quality of the work of other auditors through appropriate direction, coordination, and evaluation of the results of their work.
- Strengthen the lead auditor's understanding of the knowledge, education, and skills of those engagement team members from an other auditor who participate in supervisory activities.
- Enable the lead auditor to delegate certain supervisory activities to appropriate other auditors outside of the lead auditor's registered accounting firm.
- Clarify the substance of the interactions between the lead auditor and other auditors.

In order to clearly achieve the objectives above, there are certain practical implementation considerations that will need to be deliberated and resolved. The potential benefits of the Proposal are significant and, while some of these considerations are complex and challenging, we do not believe any of these should stand in the way of completing this important project. We stand ready to engage constructively with the Board and other stakeholders to provide our perspective and experiences in order to facilitate the development of improvements to the PCAOB's auditing standards that will enhance audit quality. A brief summary of the primary matters for additional consideration that we have identified is as follows (we offer further thoughts on each in Appendix 1):

Definition, Roles, and Responsibilities of the Lead Auditor, Including Sufficiency of Participation. We believe that the appropriate oversight of other auditors is achieved through a combination of the lead auditor's direct participation in the audit as well as other factors, such as sufficient involvement in, and supervision of, the work of other auditors. We therefore offer recommendations to achieve this goal through modifications to the definition of lead auditor. We also offer thoughts on developing requirements and guidance that provide necessary levels of scalability arising from the continuing evolution of (1) the way in which financial information and reporting is organized, processed, and recorded by complex, multi-national entities and (2) the manner in which accounting firms (and their networks) are organizing themselves, structuring their engagement teams, and innovating audit execution techniques.

Determining the Other Auditor's Compliance with Independence and Ethics Requirements. Our recommendations support the goal of a risk-based approach that acknowledges the ability to rely on an effective shared system of quality control at the network level.

Dividing Responsibility for the Audit with Another Accounting Firm. We fully support the continued practice of enabling registered accounting firms to make reference to the audit of an other auditor in the auditor's report. Our observations and recommendations serve to preserve and enhance a long-standing and necessary practice.

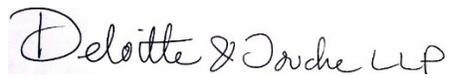
We offer further observations on other areas of the Proposal in Appendix 2 related to the auditor's performance requirements, as well as editorial comments in Appendix 3.

We commend the PCAOB Staff for devoting a significant portion of the May 18, 2016, Standing Advisory Group meeting ("SAG Meeting") to discussing matters relevant to the Proposal and hearing input from a variety of stakeholders. Furthermore, we recommend that the Board perform outreach with the International Auditing and Assurance Standards Board (IAASB), which has recently issued an Invitation to Comment, *Enhancing Audit Quality in the Public Interest — A Focus on Professional Skepticism, Quality Control and Group Audits* (the ITC), which includes a number of proposed actions to enhance the IAASB's standards related to quality control and group audits. As the Proposal has noted, many public accounting firms have based their methodologies on the IAASB's standards. The information obtained from the ITC (including identification of challenges that auditors face) and the comments from respondents may be useful to the PCAOB as it continues with its standard-setting activities. Similarly, the IAASB may also benefit from the perspectives of the PCAOB and views of commenters to the PCAOB's Proposal. Therefore, we encourage the PCAOB to engage constructively with the IAASB on this project.

* * *

D&T appreciates the opportunity to provide our perspectives on these important topics. Our comments are intended to assist the PCAOB in analyzing the relevant issues and potential effects of the Proposal. We stand ready to collaborate with the PCAOB on these important matters. If you have any questions or would like to discuss these issues further, please contact Dave Sullivan at 714-436-7788 or Megan Zietsman at 203-761-3142.

Very truly yours,

The image shows a handwritten signature in cursive script that reads "Deloitte & Touche LLP". The signature is written in black ink on a light-colored background.

Deloitte & Touche LLP

cc: James R. Doty, PCAOB Chairman
Lewis H. Ferguson, PCAOB Member
Jeannette M. Franzel, PCAOB Member
Jay D. Hanson, PCAOB Member
Steven B. Harris, PCAOB Member
Martin F. Baumann, PCAOB Chief Auditor and Director of Professional Standards

Mary Jo White, SEC Chair
Kara M. Stein, SEC Commissioner
Michael S. Piwowar, SEC Commissioner
James V. Schnurr, SEC Chief Accountant
Wesley R. Bricker, Interim Chief Accountant
Brian T. Croteau, SEC Deputy Chief Accountant
Russell G. Golden, FASB Chairman

APPENDIX 1

Definition, Roles, and Responsibilities of the Lead Auditor, Including Sufficiency of Participation

As articulated in the “Overall Comments” section of this letter, we recognize and support the Board’s objectives and believe that sufficient oversight and involvement by the lead auditor in an audit that involves other accounting firms is critical to audit quality. We fully support strengthening requirements in the PCAOB’s standards in this area. As noted in the Release, many accounting firms and networks, including the Deloitte network, have adopted requirements and guidance beyond the current requirements of PCAOB Auditing Standard 1205, Part of the Audit Performed by Other Independent Auditors. We believe embedding leading practices into the standards of the PCAOB is appropriate and will be beneficial to audit quality.

We believe that effective oversight of other auditors is achieved through a combination of the lead auditor’s direct participation in the audit as well as other factors such as sufficient involvement in, and supervision of, the work of other auditors. As currently drafted, we believe the Proposal could be improved by:

- Defining lead auditor more broadly by enabling individuals from more than one registered accounting firm to perform certain supervisory audit activities and procedures in a multi-national audit when those activities and procedures may be better executed by other auditors who belong to a different accounting firm.
- Applying multiple criteria to demonstrate sufficient involvement as lead auditor, rather than having direct participation as the predominant criteria.
- Clearly enabling the lead auditor to follow a scalable, risk-based approach to determine the nature and extent of the necessary supervision of, and involvement with, other auditors.
- Recognizing that global networks may have established a shared system of quality control (i.e., network-level policies, processes, and controls) that, when operating effectively and monitored appropriately, should influence how the lead auditor achieves the requirements of the PCAOB’s standards.

As currently drafted, there may be circumstances, based on the structure of the company being audited and the nature of its cross-border operations and financial reporting, where it will be difficult to identify a registered public accounting firm to serve as the lead auditor.

Lead Auditor — Definition. The definition of lead auditor (PCAOB Auditing Standard 2101, *Audit Planning* (AS 2101)). Paragraph A4(b) appears to preclude other auditors from fulfilling certain planning and supervisory roles and responsibilities designated in the Proposal, as such requirements are for the lead auditor to fulfill. At the same time, AS 1201 allows other auditors, as members of the engagement team (AS 2101.A3(a)), to assist the engagement partner in fulfilling the engagement partner’s supervisory responsibilities identified in AS 1201. We believe this dichotomy may create confusion as to which supervisory activities the other auditor may or may not perform.

In addition, we believe that certain requirements assigned to the lead auditor may better be performed by an other auditor that is more familiar with the language, culture, business environment, and laws and regulations of the business unit or location (and is near the business unit or location).

- For example, we do not believe that in all cases the lead auditor would be in the best position to execute the requirements to gain an understanding of each [individual] other auditor’s “knowledge of the SEC and PCAOB independence requirements and their experience in applying those requirements” (AS 2101.B4(a); see further comment in Independence section

below). These procedures may be better performed either solely by the other auditor, or in combination with the lead auditor, as opposed to solely by the lead auditor.

- For example, in a diversified company, identifying and assessing the risks of material misstatement at individual locations or business units where an other auditor is being used is an activity that is best performed with involvement by both the lead auditor and the other auditor. Similarly, in a situation of a newly acquired subsidiary in an other auditor's jurisdiction, the other auditor may have much greater knowledge and understanding of the location and the risks of material misstatement that the subsidiary may pose to the consolidated financial statements than the lead auditor.

Another challenge with respect to the proposed definition of lead auditor being limited to a single registered accounting firm is that in certain cases, the engagement partner's team may be part of a different legal entity than the engagement partner. This may be due to local laws or regulations, such as those that require a separate accounting firm to be established within individual states or provinces within a country. Furthermore, the linkage of lead auditor to a registered accounting firm is not consistent with current practice or the existing ability under AS 1201 to allow individuals from different firms to assist the engagement partner with their AS 1201 supervisory responsibilities. We believe audit quality is best served by ensuring that the appropriate engagement team is in place, without undue emphasis being placed on the legal entities in which these resources reside.

We believe the clearest approach would be to define lead auditor as "the engagement partner, the engagement partner's team, and designated individuals from other auditors who are performing planning and supervisory activities." This would eliminate the categorical relationship of the lead auditor to a single registered accounting firm. An expanded definition also would enable the engagement partner to identify, using judgment and based on their knowledge and experience and on the facts and circumstances of the company and its operations, those members of the engagement team who are best suited to directing and supervising the identification, assessment, design, and performance of procedures to respond to risks of material misstatement, in addition to assessing considerations related to ethics and independence. This is of particular importance in a multi-tiered structure (i.e., where an other auditor is supervising the work of a second other auditor; for example, where there is a sub-consolidation of financial information in a region).

Sufficiency of Participation as Predominant Lead Auditor Criterion. The Proposal provides limited criteria for determining the lead auditor; specifically, the only criterion described in the Proposal is 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. We are concerned that this one data point, coupled with the narrow definition of lead auditor discussed above, will create a challenge in identifying who may serve as lead auditor. This challenge could be partially mitigated if the changes to the definition and responsibilities of lead auditor that we have suggested above are reflected in the final amendments to the PCAOB's standards. Otherwise, we have concerns that focusing only on the quantitative metric of "coverage" of performing audit procedures that address risks may result in the inability for any registered accounting firm to meet the lead auditor definition and requirements to serve as such.

- For example, a company's operations are spread across business units/locations in 50 global jurisdictions where each location contains two percent of consolidated totals. In that case, in order to execute the audit, dozens of accounting firms will likely have to participate in the audit (e.g., due to local licensing and other laws and regulations that preclude accounting firms performing work in jurisdictions where they are not licensed). The engagement partner's firm may be selected based on factors such as the domicile of the company, its key decision makers, and the location of its consolidation activities and majority of shareholders. But that same firm may only directly audit small percentages of consolidated account balances. It is unclear whether in such a circumstance, under the Proposal, the engagement partner's firm (which is also the registered accounting firm) would meet the requirements of being the lead auditor.

- For example, a company may process most of its financial reporting transactions in one or more shared service centers located in jurisdictions outside the jurisdiction where the company is domiciled. Other accounting firms may perform the audit work at these shared service centers. Similar to the preceding example, the registered accounting firm in the jurisdiction where the company is domiciled may only directly audit a small portion of the consolidated financial statements. It is unclear whether in such a circumstance, under the Proposal, the registered accounting firm in the jurisdiction of the company's domicile could meet the requirements of being the lead auditor.
- For example, a company considered a foreign private issuer because of the requirements of the Securities and Exchange Commission (SEC) (including the domicile of the majority of its shareholders) may have the majority of its key decision makers and operations in a different jurisdiction than where the company is domiciled. The registered accounting firm in the jurisdiction of the company's domicile may not, based on licensing laws or regulations, be able to perform procedures in the jurisdiction where the majority of operations exist. It is unclear whether in such a circumstance, under the Proposal, the registered accounting firm in the jurisdiction of the company's domicile could meet the requirements of being the lead auditor.

We believe that there are multiple criteria that should be considered in determining which registered accounting firm can and should act as the lead auditor, beyond just the consideration of the risks of material misstatement associated with the portion of the company's financial statements audited by the engagement partner's firm relative to the portion audited by other auditors. These criteria should include not only factors related to the company (e.g., the legal domicile of the company, the location of the company books and records, the location of the company's executives and key decision makers) but also factors related to the auditor and audit (e.g., professional licensing requirements; the lead auditor's involvement with the other auditors; knowledge of, and experience with, the other auditor; the nature of the business unit or location audited by the other auditor; the business environment and culture in which the other auditor operates).

We believe these additional criteria would be helpful in identifying the lead auditor and in developing a risk-based framework for supervision of other auditors by the lead auditor and engagement team. If a shared system of quality control at the network level exists and is operating effectively, we believe reliance by the lead auditor on such commonalities should influence the nature, timing, and extent of direction and supervision of other auditors from the same network. A shared system of quality control, when operating effectively, provides shared methodologies and a common "language" and understanding that is distinct from other auditors outside of the network. We believe the standard should recognize this distinction as part of its risk-based, scalable approach to direction and supervision.

We believe the requirements in AS 2101.B2 should also be expanded to include the following considerations:

- **The involvement of the lead auditor.** We believe that in-depth involvement of the lead auditor in the audit (including the work performed by other auditors) is the most significant factor in determining that a quality audit will occur. The necessary level of lead auditor involvement in work performed by other auditors should be based on the factors in AS 2101.12, as well as on the lead auditor's assessment of the competence and expertise of the other auditors. For example, if an other auditor is performing audit procedures at a location with a relatively small percentage of the consolidated totals, but the location operates in an unstable economic environment and its financial information gives rise to significant or higher risks of material misstatement, we believe that it would be imperative that the lead auditor be meaningfully involved in the work performed by this other auditor.
- **The factors in AS 2101.12.** AS 2101.12 identifies factors that are relevant to the identification and assessment of risks of material misstatement associated with a location or business unit. In addition to these factors being important to identifying risks of material

misstatement, they also provide relevant considerations for determining the necessary level of involvement by the lead auditor in the other auditor's work. For example, consider the scenario where the financial information at a business unit does not have any significant risks, the systems are highly centralized and automated, there is no history of errors, and the other auditors are competent and experienced. Even if the materiality of the business unit is significant in comparison to the consolidated entity, the lead auditor may determine that the necessary level of direct involvement in the work performed by the other auditor may be less extensive than locations with higher risks of material misstatement.

- **The competence and experience of the other auditor.** Understanding the knowledge, education, and skills of the other auditor is a critical factor in determining how involved the lead auditor needs to be in the work of the other auditor. Information such as past inspections results, the experience and knowledge of the other auditor (including whether the other auditor is part of the lead auditor's network), and the lead auditor's interactions with the other auditor all contribute to the lead auditor's determination as to whether the other auditor is capable of performing the requested work. Determination of the competence and experience of the other auditor will influence the lead auditor's involvement with the auditor:
 - For example, if the lead auditor determines that even though an other auditor has received appropriate training and appears sufficiently skilled, they have little experience performing audit procedures in the areas where the lead auditor is asking them to perform procedures, the lead auditor may determine it appropriate to be more heavily involved in the direction and supervision of the other auditor's work.
 - For example, if the lead auditor has extensive experience working with the other auditor, has first-hand knowledge of their skills, and has determined that the other auditor is capable of assisting the lead auditor with supervisory activities, the lead auditor may determine that the necessary level of involvement in the other auditor's work does not need to be as extensive as in the previous example.
- **The nature, timing, and extent of communication with the other auditor.**
 - We believe that ongoing two-way communication between those auditors who are responsible for supervisory activities (whether engagement partner, other members of the lead auditor's team, or other auditors) and other engagement team members underpins the performance of a quality audit and is therefore essential. Accordingly, we are supportive of enhancements to the PCAOB's standards that will drive appropriate and effective two-way communication. We also believe that it is the engagement partner's responsibility to determine that the appropriate individuals are involved in the supervisory activities of an audit. The appropriate nature, timing, and extent of communication between auditors should be risk-based and scalable, and therefore should be a function of many factors, including:
 - The experience the lead auditor has with working with the other auditor and the resulting understanding of their knowledge, education, and skills.
 - The results of PCAOB inspections, internal practice reviews (if within the same network), other inspection results, and their relevance to the other auditor's work.
 - The complexity and nature of judgments related to the procedures that the lead auditor has requested the other auditor to perform, including whether the other auditor is responsible for performing procedures related to significant risks.
 - If in place and effective, a shared system of quality control for network firms.
 - The business and cultural environment in which the other auditor operates.
 - The factors described in current AS 1201.6.

We therefore recommend that AS 2101.B2 be modified to give appropriate recognition to qualitative factors that are critical in determining the sufficiency of the lead auditor's participation in the audit.

Audit Documentation. Accounting firms continue to evolve and innovate in terms of organizational structure, engagement team composition, and audit execution techniques. This means that:

- Engagement team members may not all be from the same office (even when they are from the same firm).
- Some engagement team members may work remotely some, most, or all of the time.
- Audit tools and techniques are becoming more data-driven.
- Audit documentation and retention methods are increasingly paperless and virtual, in keeping with similar changes in company record retention.

Challenges with respect to access to audit documentation prepared by other auditors and audit documentation retention continue to exist, and are for the most part driven by jurisdictional laws and regulations, including privacy and confidentiality. As more jurisdictions implement mandatory firm rotation, the use of firms unaffiliated with the engagement partner's firm will likely increase, which will increase the challenges related to access to audit documentation. It is important that the PCAOB's auditing standards are able to be operationalized in an environment in which work structures and the nature of audit evidence will continue to change.

PCAOB Auditing Standard 1215, *Audit Documentation* (AS 1215), requires that "[t]he 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 [AS 1215] is prepared and retained. Audit documentation supporting the work performed by other offices of the firm and other auditors must be retained by or be accessible to the office issuing the auditor's report" (AS 1215.18). The following identifies certain concerns that we have regarding changes to the PCAOB's standards related to audit documentation, and our suggested recommendations:

- We believe AS 1215.19A is overly focused on the "office issuing the report." We agree that it is reasonable to expect that a list of the work papers reviewed by the lead auditor or other auditors assisting the lead auditor be maintained; however, requiring this list to be maintained by the office issuing the auditor's report does not seem necessary as long as the list is accessible to the firm issuing the auditor's report. Furthermore, requiring this information to be prepared and maintained by the office issuing the auditor's report would likely be very burdensome and time consuming for many large audit engagements, especially during a period of time (i.e., near the auditor's report date) when the lead auditor's team would be most busy. Modifying the requirement in AS 1215.19A such that information is accessible to the firm issuing the auditor's report would also address our concerns related to the requirements in AS 1215.19, which requires that the office issuing the auditor's report obtain, review, and retain certain documents, which include those described in AS 1201.B2(c) and (d).
- The requirements in AS 1215.19 and 19A do not take into account an engagement team that has a multi-tiered structure; the judgments made by the engagement partner or lead auditor on establishing the most appropriate supervisory team; the engagement team's decisions on what constitutes appropriate audit evidence; and the structure of the company that is being audited. We believe it is appropriate for the lead auditor to consider how the company's financial information is consolidated in order to determine how to obtain sufficient appropriate audit evidence and how the audit documentation is best maintained (including obtaining the documentation discussed in AS 1215.19 and 19A); we believe the Proposal may be further enhanced to reflect these judgments. To illustrate this concept, we offer the following example:

- A company has subsidiaries in the United States, the UK, and other countries. The corporate parent is based in the United States.
- Accounting Firm #1 is the lead auditor, and audits the U.S. subsidiary and the corporate parent. Accounting Firm #2 is an other auditor, and audits the UK subsidiary.
- The engagement partner has determined that the work of Accounting Firm #2 on the UK subsidiary will be used as audit evidence. The items noted in AS 1215.19 and 19A will be obtained from Accounting Firm #2.
- The UK subsidiary has smaller subsidiaries in countries outside of the UK that consolidate into the UK subsidiary. Because of licensing and other laws and regulations, Accounting Firm #3 will be used to perform audit procedures on subsidiaries in countries other than the UK. The lead auditor is appropriately involved in the decisions that Accounting Firm #2 makes, and has determined that Accounting Firm #2 is appropriately supervising any other auditors that are being used.
- Accounting Firm #2 will obtain the items noted in AS 1215.19 and 19A from Accounting Firm #3, as they are best placed to review and understand the work that has been performed. However, given that Accounting Firm #2 is reporting to the lead auditor on behalf of Accounting Firm #2 and Accounting Firm #3, Accounting Firm #2 will provide the items noted in AS 1215.19 and 19A for the entities audited by Accounting Firm #2 and Accounting Firm #3. Therefore, it would not be necessary for the lead auditor to obtain and keep in the audit documentation of Accounting Firm #1 the items noted in AS 1215.19 and 19A in relation to Accounting Firm #3.
- We do not believe that audit work is performed by “an office”; however, AS 1219.19(e) requires that the office issuing the auditor’s report reconcile financial statement amounts to the information underlying the consolidated financial statements. The lead auditor is responsible for determining that the financial statement amounts audited reconcile to the information underlying the consolidated financial statements; therefore, AS 1219.19(e) should be modified to reflect who has this overall responsibility.

Determining the Other Auditor’s Compliance with Independence and Ethics Requirements

AS 2101.B4 requires that, in addition to confirming the other auditors’ compliance with SEC and PCAOB independence and ethics requirements, the lead auditor is required to understand each other auditor’s knowledge of the requirements and their experience in applying the requirements. We agree with the requirement to obtain a written representation from each other auditor that the other auditor is in compliance with SEC and PCAOB independence and ethics requirements. However, it is unclear whether the requirement is applicable to each individual of the other auditor, to the other auditor engagement team collectively, to the firm, or to the network. We believe there will be significant challenges if the requirement means that the lead auditor needs to evaluate the knowledge and experience of every individual of the other auditor.

For example, one interpretation of this requirement could be that the lead auditor needs to evaluate all of the ethics and independence learning material provided by the other auditor’s firm or network. This may be particularly challenging when the other auditor is from a different network than the lead auditor due to the proprietary nature of the learning material developed or delivered by the other auditor to its personnel. The requirements of the PCAOB’s Proposal may also be interpreted to mean that the other auditor must provide detailed information about other engagements performed by the other auditor, which may be subject to privacy and confidentiality laws and regulations. In addition, it is unclear whether every member of the other auditor engagement team is expected to provide detailed information on ethics and independence or whether there can be consideration of network-level controls and processes related to monitoring compliance with ethical and independence requirements. Meeting this detailed requirement for each individual across a large, complex, multi-

national audit will be challenging, particularly if the lead auditor is unable to leverage a shared system of quality control within the lead auditor's network (if one is present and operating effectively).

We believe a risk-based approach to determining whether to obtain any additional understanding beyond the representation, and if so the nature and extent of that understanding, would be more appropriate. This approach would allow for auditor judgment to be applied and for the auditor's effort to be focused on the circumstances where additional information is important to judgments about the competence of the other auditor, or where contradictory evidence with respect to the other auditors' independence may present itself (as AS 2101.B4 already provides for). Furthermore, we believe the lead auditor should be able to rely on a shared system of quality control at the network level, when found to be operating effectively, to address independence and ethics requirements.

Therefore, we recommend clarifying in AS 2101.B4 to whom the requirement to obtain a written representation from is needed. However, we also believe that based on the engagement partner's professional judgment, including their knowledge of, and experience with, the other auditor, and the facts and circumstances, the lead auditor should be able to determine the additional performance requirements that are appropriate.

Dividing Responsibility for the Audit with Another Accounting Firm

We strongly support retention of the engagement partner's ability to make reference (i.e., divide responsibility) in the auditor's report to another auditor as governed currently by AS 1205. The ability for the lead auditor to divide responsibility for the audit with another accounting firm is a recognized and allowable approach in the United States. There are no compelling practice issues that we are aware of that would suggest a need to change an approach that has long been permitted. We do not believe that additional requirements, including supervisory requirements, are necessary to describe the responsibilities of the engagement partner's firm in situations in which the lead auditor divides responsibility for the audit. We believe that certain aspects of PCAOB Auditing Standard 1206, *Dividing Responsibility for the Audit with Another Accounting Firm* (AS 1206), are in conflict with the Board's goals with respect to divided responsibility, and we further describe our observations and recommendations to the Proposed Auditing Standard below.

The Principles Underlying Division of Responsibility. Currently, the decision to divide responsibility does not happen often and most often occurs when a significant transaction occurs toward the end of the fiscal year and the lead auditor determines that they will not have appropriate time to assume responsibility for the work performed by the other auditor, or where there is an equity method investment and there is an inability to obtain unfettered access to all people and information in order to assume responsibility for the work of the referred-to auditor. In such circumstances the auditor's report provides transparency to the users of the audited financial statements about the responsibility taken by the lead auditor, as often evidenced with language similar to: "Our opinion insofar as it relates to Subsidiary B is based solely on the opinion of the other auditor."

The Proposal, however, contains additional requirements that go beyond current practice and that may result in more opaqueness around the responsibility and activities the lead auditor is required to undertake with respect to the referred-to auditor, as well as the purpose of such activities. For example, the Proposal (AS 2101.14) requires that the lead auditor have discussions with the referred-to auditor to identify and assess risks of material misstatement associated with the location. As another example, AS 2401.53 requires that the lead auditor discuss with the referred-to auditor the extent of work that needs to be performed to address certain fraud risks.

This greater level of involvement by the lead auditor in the work of the referred-to auditor diminishes the "clear line" with respect to responsibility and what the lead auditor does or does not know about the financial information at that location. For example, based on the discussion mentioned in the previous paragraph, would the lead auditor be compelled to evaluate how the referred-to auditor

responded to an identified risk of material misstatement? At what point would the lead auditor be perceived to have gone beyond basing the opinion as it relates to a particular subsidiary or equity method investee “solely” on the referred-to auditor’s opinion? The predominant factors influencing the decision to divide responsibility today are primarily timing (e.g., late-year acquisitions) and access (e.g., equity method investments that are not controlled by the company being audited). The increase in the required extent of involvement in the work of the referred-to auditor, and a greater understanding of the referred-to auditor’s response to risks, may result in division of responsibility for different factors than exist today. We are not sure whether the Board intended such an outcome. This may be why the Proposal does not carry forward existing guidance (AS 1205.06) which provides considerations in determining whether to make reference to another auditor. However, we find this guidance is used in practice today and we believe it is helpful and should be retained.

Dividing Responsibility when Different Financial Reporting Frameworks Have Been Used. We note the Proposed Auditing Standard eliminates the current option of dividing responsibility when a different financial reporting framework has been used. This option is used in practice today and is recognized by the SEC. The SEC’s Financial Reporting Manual (FRM) states “...financial statements of subsidiaries or investees of a foreign private issuer are sometimes prepared in differing GAAP’s than that of the registrant. The audit report should be clear as to which auditor is taking responsibility for auditing the conversion of the GAAP of the subsidiary or investee to the GAAP of the issuer, as well as auditing the U.S. GAAP reconciliation” (FRM 6820.7). As far as we are aware, there have been no recognized practice issues or challenges arising from dividing responsibility when a different financial reporting framework has been used.

Given the broad use of International Financial Reporting Standards (IFRS) globally, in a multi-national group audit where subsidiaries have statutory audit requirements, often the financial information of the company is kept in IFRS for statutory audit purposes and then converted to U.S. GAAP for consolidated reporting purposes. With an expected turnover in subsidiary auditors arising from mandatory firm rotation in certain jurisdictions, we believe that an increase in dividing responsibility with a subsidiary auditor may occur. We believe in such a circumstance, where local GAAP is not U.S. GAAP, continuing the current practice of being able to divide responsibility when a different financial reporting framework is used is important.

APPENDIX 2

The comments noted in this section are intended to clarify the auditor performance requirements to avoid misinterpretation.

Obtaining the Other Auditor's Written Report. The Proposal could clarify what will be sufficient for the lead auditor to obtain to satisfy the requirement in AS 1201.B2(d). For example:

- Is it sufficient for the lead auditor to receive only the items noted in AS 1215.19 from the other auditor, provided the receipt of such items results in the lead auditor being appropriately informed about the work performed and the related results?
- Is it sufficient for the lead auditor to obtain only the working papers from the other auditor and not a summary report, provided the receipt of such working papers results in the lead auditor being appropriately informed about the work performed and the related results? For example, if the other auditor performs only an observation of an inventory count, would it be sufficient for the other auditor to provide all working papers to the lead auditor (assuming that the working papers include information such that the lead auditor is appropriately informed about the work performed and the related results)?

Specifically related to Question 53 in Appendix 4, while superseding AI 10 generally seems appropriate, paragraphs .11-.17 are helpful in providing consistency related to lead auditor and other auditor communications; this guidance can be especially helpful when the other auditor is not from the same network as the lead auditor. We recommend retaining or developing new example communications that may be used, together with an explanation of when different types of communications might be more appropriate. For example, we believe it would be helpful for additional clarity to be provided about the circumstances that may necessitate or require an opinion-style report from the other auditor to the lead auditor.

Discussions with Other Auditors. AS 2101.14 requires the lead auditor to discuss 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. However, the lead auditor may initially identify and assess risks *prior* to determining the locations where procedures will be performed to respond to those risks (and therefore prior to identifying an other auditor). It is important that the standard recognize the iterative nature of the planning process to enable risk assessment activities and other auditor outreach to occur appropriate to the facts and circumstances and less in a seemingly required sequential manner.

Specialized Skill or Knowledge. Clarity is needed as to the purpose for the proposed wording in AS 2101.16, which states “[t]he 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.” There are many examples of where specialized skills may be needed and the current wording allows for appropriate consideration. Additional clarity as to why there is an added focus on knowledge of foreign jurisdictions is needed, especially in light of this requirement being applicable to “the auditor” (e.g., the auditor in a foreign jurisdiction is now required to consider whether knowledge of the foreign jurisdiction in which they practice is necessary). While Page A4-25 of the Release implies that the reasoning for this change is to assist with gaining an understanding of the qualifications of the other auditor’s supervisory personnel (and who assist the lead auditor with planning or supervision), the explanatory phrase added to AS 2101.16 does not appear to achieve this goal.

Changes in Audit Procedures. AS 1201.B2 (b) states that the lead auditor should “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.” Requiring that changes in the nature, timing, and extent of audit procedures be in writing in all cases seems overly onerous and inconsistent with

current practice of how the engagement partner (or engagement team members who assist with fulfilling the engagement partner's responsibility pursuant to AS 1201) would manage communications about necessary changes in work performed by engagement team members. Determining whether changes to audit procedures are necessary and making the necessary communications often involves a collaborative effort between engagement team members and results in direct changes to related working papers (versus a separate document identifying the change, in addition to the change in the related working paper). As the lead auditor has the ability to review working papers of the other auditor, the lead auditor has the ability to determine that changes to audit procedures were appropriately incorporated; therefore, having an additional layer of documentation seems unnecessary.

Recommended Changes to Provide Clarity When Dividing Responsibility. In light of our analysis of the Proposed Auditing Standard, we have identified several areas where improvements may be warranted to provide further clarity for auditors:

- AS 1206.2 states that “[t]he 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...” This phrasing implies that the object of the lead auditor is to communicate with the referred-to auditor as it relates to the audit procedures to be performed with respect to the consolidation, which we do not believe is the intent. We recommend that the PCAOB consider modifying the objective to make it clear that the objective of the lead auditor is to perform procedures that are necessary in order to make reference to the report of the referred-to auditor in the lead auditor’s report, and make the necessary disclosures in the lead auditor’s report.
- AS 1206.08(b) states that the lead auditor’s report should “[i]dentify 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.” Given that the referred-to auditor’s report is included in the filing, it does not seem necessary to identify them specifically by name in the auditor’s report. We recommend the PCAOB re-consider the necessity of this requirement.
- AS 1206.08(c) states that the lead auditor’s report should “[d]isclose 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.” Furthermore, the second note to AS 1206.1 states that “[t]his 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 [AS 1206] in relation to each of the referred-to auditors individually.” In current practice, if there is more than one referred-to auditor, the auditor’s report generally combines the disclosure about the magnitude of the portion of the company’s financial statements and, if applicable, internal control over financial reporting, for all referred-to auditors, which has been a longstanding and accepted practice with auditor’s reports filed with the SEC. We recommend that the Board clarify whether the intention is to require that this information be disclosed for each referred-to auditor and consider, in making this clarification, how this would conflict with current practice and what is currently acceptable to the SEC. In addition, we request that the PCAOB include an illustrative report example when multiple referred-to auditors exist in the final standard.
- AS 1206 does not appear to have sufficient guidance on dividing responsibility for an audit of internal control over financial reporting, as the Proposed Auditing Standard appears to be heavily focused on the financial statement audit. Some examples that lack reference to audits of internal control over financial reporting include:
 - AS 1206.1: Note: This standard applies when the lead auditor divides responsibility for the audit with one or more other auditors.

- AS 1206.4: 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.

It would be more appropriate for the reference to "the audit" in the above examples to refer to both the financial statement audit and the audit of internal control over financial reporting given that the auditor can divide responsibility for the financial statement audit or the audit of internal control over financial reporting. Alternatively, when phrases such as "the audit" are used, they could be footnoted and clarified that such phrases refer both to the audit of the financial statements and the audit of internal control over financial reporting, if applicable.

- AS 1206.01 states "[t]his standard establishes requirements for the lead auditor 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." However, we have observed that throughout the Proposal there are auditor performance requirements when a referred-to auditor exists (e.g., Appendix B to AS 1201). Accordingly, we recommend that the Board clarify in the Proposed Auditing Standard that requirements exist in other PCAOB standards related to when the lead auditor divides responsibility and that an appendix or footnote reference be added that identifies such other requirements.
- It is unclear as to why in situations where the lead auditor is unable to divide responsibility with another accounting firm, the lead auditor's performance requirements are limited only to the three options presented in AS 1206.7. We believe that another alternative is to allow for the lead auditor to identify a different other auditor and appropriately apply the requirements of the Proposal when using an other auditor. Therefore, we recommend that this additional alternative be included in AS 1206.7.
- We recommend that in AS 1206, Appendix B, an example is provided for the situation in which the lead auditor is making reference to a referred-to auditor for the financial statement audit only, and the lead auditor's report on the financial statements is separate from the lead auditor's report on internal control over financial reporting (given that this is the most common scenario that is encountered).

APPENDIX 3

<p>AS 1201.B(2)(b)</p>	<p>We recommend making the following changes to improve readability and clarify the meaning: Note: Based on the necessary extent of supervision of the second other auditor's work by the lead auditor, it may be necessary for the lead auditor (rather than the other auditor who is assisting the lead auditor in supervising the second other auditor) to determine the nature, timing, and extent of procedures to be performed.</p>
<p>AS 1206.03</p>	<p>We recommend making the following changes to improve readability and clarify the meaning: The lead auditor should determine that audit procedures are performed, in coordination with the referred-to auditor, as necessary, to test and evaluate..."</p>
<p>AS 1206.7</p>	<p>It is unclear that the circumstances described in AS 1206.7 exist in situations where the lead auditor originally expected to divide responsibility with the referred-to auditor, and has subsequently determined that this is not possible. Therefore, we recommend making the following changes: In situations in which the lead auditor originally planned to divide responsibility for the audit with another accounting firm, but has subsequently determined that this is not possible is unable to divide responsibility with another accounting firm (e.g., due to concerns about the competence or independence of the referred-to auditor), the lead auditor should:...</p>
<p>AS 1206.08(c)</p>	<p>We recommend the following change to AS 1206.08(c), given that the second sentence states "[t]his may be done," and therefore using "or" instead of "and" provides flexibility as to the criteria used (as total assets and total revenues are not always the criteria used): 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, or and other appropriate criteria necessary to identify the portion of the company's financial statements audited by the referred-to auditor.</p>
<p>AS 1206, Footnote 1</p>	<p>We recommend making the following changes to clarify the meaning: 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, as well as the financial information related to equity method investments.</p>
<p>AS 1206.B1</p>	<p>We recommend the following changes to AS 1206.B1, the first paragraph of the Introductory Paragraph, to improve readability and to clarify that the statement of comprehensive income is not part of stockholders' equity: We have audited the accompanying consolidated balance sheets of X Company and subsidiaries as of December 31, 20X3 and 20X2, and the related consolidated statements of operations, comprehensive income, and stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 20X3.</p>
<p>AS 1206.B1</p>	<p>We recommend the following changes to AS 1206.B1, the Opinion Paragraph, to address grammar inconsistencies (first sentence) and to recognize that the opinion on the effectiveness of internal control over financial reporting is only for one year (second sentence): In our opinion, based on our audits and the report of Firm ABC, the consolidated financial statements referred to above present fairly, in all</p>

	<p>material respects, the financial position of X Company and subsidiaries as of December 31, 20X3 and 20X2, and the results of its their operations and its their 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)”].</p>
<p>AS 1206.B1</p>	<p>We recommend the following changes to AS 1206.B1, the second Introductory Paragraph, to better reflect that the auditor’s opinion is on the effectiveness of internal control over financial reporting:</p> <p>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, respectively, and total revenues constituting XX percent, YY percent, and ZZ percent of consolidated revenues for the years ended December 31, 20X3, 20X2, and 20X1, respectively. Those financial statements and B Company’s internal control over financial reporting were audited by Firm ABC whose report[s] has[have] been furnished to us, and our opinions, insofar as they relate to the amounts included for B Company and the effectiveness of its internal control over financial reporting, are based solely on the report[s] of Firm ABC.</p>
<p>AS 1215.19A</p>	<p>We recommend the following change to clarify that retention of work papers is by the office (as is consistent with AS 1215), not the lead auditor:</p> <p>Audit documentation of the firm office issuing the auditor’s report must contain a list of additional work papers of other auditors (beyond those described in paragraph .19 [of AS 1215]) that were reviewed by the lead auditor but not retained by the firm issuing the auditor’s report lead auditor, if any.</p>
<p>AS 1215.18, AS 1215.19, and AS 115.19(e)</p>	<p>It unclear as to what the reference to “other offices of the firm” means (i.e., offices of what firm?) in certain paragraphs in AS 1215. We recommend making the following changes to improve readability and clarify the meaning (see additional comments on AS 1215 in Appendix 2):</p> <p>AS 1215.18: 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 issuing the auditor’s report and other auditors must be retained....</p> <p>AS 1215.19: 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 offices of the firm issuing the auditor’s report and other auditors:...</p> <p>AS 1215.19(e): Sufficient information to enable the office issuing the auditor’s report to agree or to reconcile the financial statement amounts audited by other offices of the firm issuing the auditor’s report and other auditors to the information underlying the consolidated financial statements.</p>

<p>AS 2101.A3(a)(2)</p>	<p>AS 2101.A3 (a)(2) states that the engagement team includes “specialists whose work is used on the audit and who are employed by the lead auditor or another accounting firm participating in the audit.” It is unclear as to how specialists whose work is used on the audit should be considered when they are neither employed nor engaged by the lead auditor or another accounting firm participating in the audit. For example, a specialist (e.g., an IT Specialist) may be a Partner in the same firm as the lead auditor; in such a case, they would not be considered to be “employed by the lead auditor,” nor would they be an “engaged specialist.” We recommend the following change:</p> <p>a. Engagement team includes – ... (2) Specialists whose work is used on the audit and who are <u>partners, principals, shareholders, or employees of the registered public accounting firm issuing the auditor’s report employed by the lead auditor, or of</u> another accounting firm participating in the audit</p>
<p>AS 2101.A4</p>	<p>We recommend making the following changes in order to acknowledge that there may be instances where an auditor’s report may not ultimately be issued:</p> <p>Lead auditor –</p> <p>(a) The registered public accounting firm <u>engaged to issue</u> issuing the auditor’s report on the company’s financial statements and, if applicable, internal control over financial reporting; and</p> <p>(b) The engagement partner and other engagement team members who: (1) are partners, principals, shareholders, or employees of the registered public accounting firm <u>engaged to issue</u> 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.</p>
<p>AS 2101.A5</p>	<p>We recommend making the following changes in order to conform to language used in the definition of engagement team:</p> <p>Other Auditor –</p> <p>(a) A member of the engagement team who is not a partner, principal, shareholder, or employee of the <u>registered public accounting firm engaged to issue the auditor’s report</u> lead auditor; and</p> <p>(b) A public accounting firm, if any, of which such engagement team member is a partner, principal, shareholder, or employee.</p>
<p>AS 2101.A6</p>	<p>We recommend making the following changes to the definition of referred-to auditor, which is consistent with the terminology used in the Note to AS 2101.A4 and current practice:</p> <p>Referred-to Auditor – A public accounting firm, other than the <u>engagement partner’s registered accounting firm</u> 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 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.</p>
<p>AS 2101.B2</p>	<p>We recommend making the following changes to improve readability and clarify the meaning:</p> <p>In making this determination, the engagement partner should take into account 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 (which includes considering the <u>portion’s materiality of the portion of the company’s financial statements for which the engagement partner’s firm performs audit procedures</u>), in comparison with the portions for which the other auditors perform audit procedures or the portions audited by the referred-to auditors.</p>

<p>AS 2101.B4</p>	<p>We recommend making the following changes to improve readability and clarify the meaning: In an audit that involves other auditors, the lead auditor should determine each other auditor’s compliance with the SEC and PCAOB independence and ethics requirements in the context of the engagement by...</p>
<p>Use of term “public accounting firm”</p>	<p>Generally, the Proposal uses the term “accounting firm” or “registered public accounting firm.” However, in certain instances the term “public accounting firm” is used. If there is not an intended difference in the use of these terms, we recommend that the Proposal refer consistently to “accounting firm” or “registered public accounting firm.” We recommend making this change to the following paragraphs (and also recommend that the Board consider whether additional instances of the term “public accounting firm” need to be changed):</p> <ul style="list-style-type: none"> • AS 2101.A5(b) and A6 • AS 1201.A5 • AS 1215 Footnote 4 • AS 1206.A3 • AS 2201.C1.



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15 November 2017

**Re: Supplemental Request for Comment: Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Accounting Firm
PCAOB Rulemaking Docket Matter No. 042**

Dear Ms. Brown:

Ernst & Young LLP (EY) is pleased to submit these comments to the Public Company Accounting Oversight Board (PCAOB or Board) on the *Supplemental Request for Comment: Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Accounting Firm* (the Supplemental Request or the Proposal).

We appreciate the efforts the PCAOB has made to take into account our views and those of other stakeholders, particularly our concerns about the lead auditor determination and the importance of taking a scalable and risk-based approach. While we continue to support the PCAOB's efforts to strengthen the requirements for the lead auditor in an audit involving other auditors, we believe that certain revisions and clarifications are still needed.

Our comments focus on the following areas where we believe the Proposal can be improved or made more practical:

- ▶ Lead auditor determination
- ▶ Other auditors' compliance with independence and ethics requirements
- ▶ Other auditors' knowledge, skill and ability
- ▶ Risk of material misstatement
- ▶ Supervision and review
- ▶ Multi-tiered audits
- ▶ Other matters



In each section of this letter, we highlight our key areas of concern, including the practical challenges of implementing the proposed requirements, and possible alternatives.

Lead auditor determination

The Supplemental Request requires the engagement partner to determine whether his or her firm's participation is sufficient for the firm to serve as lead auditor. Under the proposal, the engagement partner would need to consider the risks of material misstatement associated with the portions of the financial statements audited by the firm relative to those portions audited by other auditors and referred-to-auditors. In response to the comments received, the Board added a requirement for the auditor to assess the importance of the issuer's locations or business units in making that determination.

As we indicated in our original comment letter, the lead auditor determination is constrained by various factors, particularly legal and other requirements governing the required involvement of the lead auditor. While the Board acknowledges some of these factors in the Supplemental Request, we do not believe the addition of a requirement to assess the importance of the locations or business units for which the lead auditor performs procedures would fully address the concerns we raised in our previous comment letter. We believe the final standard should provide guidance for these situations.

We believe the Board should also consider further clarification or examples in the final standard to help the practitioner apply the importance criterion in the determination of the lead auditor. It would be helpful for the PCAOB to acknowledge that it is aware of situations where an auditor performs relatively fewer audit procedures on global business units but is still considered the lead auditor based on various legal or regulatory requirements. We believe the Board should also indicate in the final standard that in cases where an auditor is best suited to issue the opinion and therefore serves as lead auditor but does not audit a large part of the entity, the Board expects the auditor's involvement in the work of other auditors to increase accordingly.

Other auditors' compliance with independence and ethics requirements

Independence is the cornerstone for providing trust and confidence in the capital markets. We support the Board's objective that the lead auditor determine the other auditor's compliance with the Securities and Exchange Commission's (SEC) independence and the PCAOB's independence and ethics requirements. However, we have concerns about the proposed requirement that the lead auditor gain an understanding of each other auditor's process for determining compliance with independence and ethics standards and experience in applying those requirements.

We believe we would face significant practical challenges if the lead auditor had to gain an understanding of other auditors' processes for determining compliance with independence and ethics standards when those other auditors are outside of our network. Other auditors are likely to provide only high-level descriptions of their processes. If the other auditors did provide detailed information about their processes, this information would likely need to be reviewed centrally by senior members of the independence function at the lead auditor because the lead audit team would not be in a position to properly evaluate the sufficiency of detailed policies. We believe that a detailed evaluation by independence personnel would likely result in additional cost that would outweigh the potential benefits.

We believe the lead auditor should focus, instead, on whether the other auditor has a system of quality control designed to provide reasonable assurance that the other auditor complies with the relevant independence and ethics requirements. Accounting firms around the world are required to comply with quality control standards, which may vary in detail, but promote a consistent objective. As such, we believe the lead auditor should obtain a representation from an other auditor that the other auditor has a system of quality control that is designed to provide reasonable assurance that the other auditor complies with relevant independence and ethics requirements. We believe that requiring such a representation would eliminate the subjectivity involved in understanding, and essentially evaluating, an other auditor's quality control process and would provide an objective framework for the lead auditor to determine whether it can place reliance on the other auditor.

Additionally, we believe that when a lead auditor and the other auditor are members of a network that uses global processes and tools to validate compliance with quality control standards, the lead auditor should not be required to obtain a written representation that the other auditor has a system of quality control that is designed to provide reasonable assurance that such auditor complies with the independence and ethical standards.

Although we support transparent and ongoing communication between the lead and other auditors, and we support the key concepts in proposed paragraph .B4b of AS 2101 of the Supplemental Request, we foresee legal challenges in obtaining written communication of all relationships identified between the other auditor and those in financial reporting oversight roles (FRORs) given the privacy laws in effect in certain jurisdictions. As such, we suggest adding "when legally permissible" to the requirement.

We also suggest clarifying in the proposed standard that the requirement for written communication of all relationships that may reasonably be thought to bear on independence only relates to those matters that bear on independence at the issuer audit client. Further, it should be clarified that the requirement is based on and is consistent with PCAOB Rule 3526, and the expectation is that matters disclosed would be expected to be communicated to the audit committee of the issuer audit client.

Furthermore, the discussion in the Supplemental Request of the note in paragraph .B4b of AS 2101 indicates that relevant information about the other auditor may come either directly from the other auditor or from other sources, such as regulatory reports or news articles. It is unclear to us whether the Board's intent is to require the lead auditor to design procedures to identify such information from third-party sources. We believe that there may be significant practical challenges to executing procedures to search for, find and address matters that may arise from third-party sources, particularly news articles. The sources the auditor would need to search and the depth and rigor of the search are unclear.

Requiring the lead auditor to search third-party sources would add unnecessary cost without resulting in a commensurate increase in audit quality. Given the assertions and disclosures required of the other auditor, there should not be a requirement to identify information from third-party sources. Thus, we believe the lead auditor should be focused on contradictory evidence that comes to light during the performance of the audit, is specific to the relevant issuer audit client, and that contradicts the representations made by the other auditor. We suggest the PCAOB clarify this point.

We have marked up proposed paragraph .B4 of AS 2101 below to reflect the edits we suggest that the PCAOB make:

.B4 In an audit that involves other auditors,¹ the lead auditor should determine each other auditor's compliance with the SEC independence requirements and PCAOB independence and ethics requirements by obtaining from each other auditor:

- a. ~~Gaining an understanding of each other auditor's (1) process for determining compliance with the SEC independence requirements and PCAOB independence and ethics requirements and (2) experience in applying the requirements; and~~ A written representation that such auditor has a system of quality control that is designed to provide reasonable assurance that such auditor complies with the independence and ethical standards specified by the lead auditor as being applicable; and
- b. When legally permissible, a ~~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; and
- c. A written representation that it is, or is not, in compliance with SEC independence requirements and PCAOB independence and ethics requirements and, if it is not, a description of the nature of any noncompliance.

Note: 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.

Note: If the lead auditor is unable to obtain the written representation in .B4a or becomes aware of information during the course of the audit that contradicts an other auditor's description of its relationships that may reasonably be thought to bear on independence or a representation made by an other auditor regarding its compliance with the SEC independence requirements and PCAOB independence and ethics requirements, the lead auditor should perform additional procedures to determine the effect of such information on the independence of the other auditor.

Note: When the lead auditor and the other auditor are within the same network, and such network utilizes global processes and tools to ensure compliance with quality control standards, the other auditor is not required to provide the representation in .B4a in AS 2101.

Other auditors' knowledge, skill and ability

We support the proposed requirement that the lead auditor gain an understanding of the knowledge, skill and ability of other auditors; however, we do not believe the lead auditor should be required to inquire about the other auditor's policies and procedures related to the assignment of individuals to audits conducted under PCAOB standards and the training of these individuals.

¹ 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.

We believe the main objective of the lead auditor should be to determine whether the other auditor possesses the requisite knowledge, skill and ability to perform the responsibilities assigned on an audit performed under PCAOB auditing standards, and we do not believe proposed paragraph .B6a of AS 2101 would achieve this objective. In practice, auditors make this determination primarily by interacting with professionals assigned to the audit, not by evaluating another firm's policies and procedures about the assignment and training process. The manner in which proposed paragraph .B6a of AS 2101 would be implemented in practice is unlikely to achieve this objective because the other auditor would likely provide only a high-level response.

Policies and procedures are proprietary, and firms may not want to share this information. In that situation, the other auditor's firm is likely to provide a boilerplate response to inquiries regarding policies and procedures on the training and assignment of individuals to the audit. This would make it difficult for the lead auditor to evaluate the policies and procedures in a manner that would allow that lead auditor to achieve the intended objectives of the Proposal.

And even if the lead audit team did obtain significant details about the other auditor's policies and procedures, the lead auditor may not be in the best position to evaluate the sufficiency of policies and procedures for assigning and training personnel for PCAOB audits. These policies and procedures would likely need to be evaluated by individuals who work in learning and resource assignment groups rather than an audit team. Having professionals outside the audit team perform a detailed evaluation of the other auditor's policies would likely result in additional cost that would outweigh the potential benefits.

Further, because there are no standards for determining what constitutes adequate processes, policies and procedures for assigning and training personnel, it is unclear what the lead auditor would do with such information. We believe the Board should address the question of how to determine whether an auditor's assignment and training processes, policies and procedures are adequate when it revises the quality control standards.

We suggest that the lead auditor perform inquiries of other auditors and obtain written representations from other auditors about their knowledge, skill and ability, but should not be required to specifically inquire about the other auditor's policies and procedures relating to training programs or the assignment of individuals to PCAOB audits. Therefore, we do not believe that proposed paragraph .B6a of AS 2101 is needed in the final standard.

Risk of material misstatement

We support the proposed amendments that would require the lead auditor to communicate to other auditors the scope of work, tolerable misstatement, the identified risks of material misstatement, and, if determined, the amount below which misstatements are clearly trivial. These communications are commonly made in practice and are important to performing an audit involving an other auditor. However, we believe the Board should clarify, in proposed paragraph .B2 of AS 1201, which risks of material misstatement the lead auditor is required to communicate to the other auditor.

Proposed paragraph .B2a of AS 2101 includes a reference to footnote 20 that refers to the requirements in AS 2110.49-51. That part of the standard requires the key engagement team members to discuss the susceptibility of the company's financial statements to material misstatement due to error or fraud. These discussions are typically limited to risks that are identified at the group level and don't result in the identification of all risks of material misstatement.

In contrast, AS 2201.30 requires the auditor to determine the likely sources of potential misstatement by asking himself or herself “what could go wrong” within a given significant account or disclosure. When complying with AS 2201.30, an auditor would identify these risks as a part of his or her work to understand each significant class of transactions and perform walkthroughs, as the risks identified are at the assertion level.

We note that if the Board intended to require the lead auditor to communicate all risks of material misstatement that are identified through procedures consistent with AS 2201.30, the lead auditor may not be in the best position to perform the procedures necessary to identify the risk of material misstatement at an assertion level for each component in a group audit.

Therefore, we recommend the following edits to clarify the risk of material misstatement to be communicated by the lead auditor in proposed paragraph .B2 of AS 1201:

a. Inform the other auditor of the following in writing:

- (1) The scope of work to be performed by the other auditor; and
- (2) Tolerable misstatement, ~~the identified significant matters affecting the~~ risks of material misstatement as required by AS 2110.49-51, and, if determined, the amount below which misstatements are clearly trivial and do not need to be accumulated relevant to the work requested to be performed.

Supervision and review

We support adding the note to proposed paragraph .B2d of AS 1201 that would clarify that the necessary level of detail of the other auditor’s documentation to be obtained and reviewed by the lead auditor should be determined by the lead auditor (or first other auditor as provided for in paragraph .B3 of AS 1201) based on the necessary extent of supervision of the other auditor’s work. We believe that this would allow the lead auditor or the first other auditor to use judgment to determine the extent of workpaper review that is required. However, we continue to have concerns that proposed paragraph .B2c of AS 1201 (which indicates the lead auditor should direct the other auditor to provide for review specified documentation) would create an expectation that workpaper review is typically required beyond the documents currently required by AS 1215.19.

Additionally, the proposed amendments to paragraph .03 of AS 1201 would make the engagement partner at the lead auditor responsible for supervising team members outside the engagement partner’s firm (i.e., team members of other auditors), including workpaper review, which is addressed in paragraph .05 of AS 1201. While we believe that paragraph .04 of AS 1201 allows the engagement partner to delegate supervisory responsibilities to other members of the team, the proposed amendment would assign overall responsibility for supervision, including workpaper review, to the lead audit engagement partner. We are concerned that the proposed amendments would lead to workpaper reviews by the lead auditor beyond those required by AS 1215.19 that are not necessary to conclude on the work performed by the other auditor.

We believe that the lead auditor should be able to apply judgment in determining the nature and extent of its supervision and review. Workpaper review may not be possible in all instances or may be less effective than other forms of supervision. Laws and regulations in many countries prevent the other auditor from transferring the workpapers or copies of the workpapers, physically or electronically, from these countries to the lead auditor. Consequently, the lead auditor may also be prevented from accessing the electronic workpaper repository remotely to review workpapers because, as a practical matter, opening the electronic workpaper remotely may automatically transfer the electronic file to the computer of the lead auditor.

In order to obtain access to this documentation, the lead auditor may have to travel to the other auditors' locations and review the workpapers on-site. In addition to the time and cost involved in obtaining work permits where necessary, it may be challenging for the lead auditor's personnel to perform these workpaper reviews when time is often constrained. In cases where the need for the workpaper review is identified late in the audit process (e.g., as a result of new transactions at the client), there may not be time to obtain appropriate work permits.

We continue to believe that other forms of involvement, such as participation in meetings with the other auditor (e.g., attending key meetings such as those in which the other auditor and audit client discuss key issues), may be appropriate procedures for the lead auditor to perform to supervise the other auditor in conjunction with the review of the audit documentation outlined in AS 1215.19. We also believe there will be instances where the review of the audit documentation required by AS 1215.19 will be sufficient without additional workpaper review. We propose the following edits to footnote 22 in proposed paragraph .B2c of AS 1201:

The specified documentation includes, but is not limited to the documentation described in AS 1215.19 and other documentation, if any, that the lead auditor determines is necessary to conclude on the other auditor's work.

Multi-tiered audits

We support the Board's revisions to the proposed amendments that would allow the lead auditor to direct the first other auditor to perform the procedures in proposed paragraph .B2a of AS 1201. We believe that the responsibility for direct communications with the second other auditor is best placed with the first other auditor. The proposed revisions in .B2a of AS 1201 maintain the basic communication structure that currently exists in multi-tiered audit arrangements. However, we believe that the proposed requirements for the lead auditor to obtain, review and retain the summary memorandum, a copy of the communications required by paragraph .B2a of AS 1201, and the documentation required by AS 1215.19 are not needed and could have unintended consequences, as described later. We believe the AS 1215.19 documentation that the first other auditor provides to the lead auditor would include any information related to the second other auditor that would require consideration from the lead auditor.

Since the first other auditor is responsible for all work provided to the lead auditor, which includes all of the work of the second auditor, the requirement for the lead auditor to obtain, review and retain the documentation required by AS 1215.19 would duplicate the review performed by the first other auditor. To avoid duplicative review, a lead auditor might decide to supervise all other auditors directly rather than include a first other auditor. While it may appear that audit quality could be enhanced by such an approach, we believe it could introduce unintended consequences that threaten audit quality.

First other auditors are often in a better position to supervise and review the work of second other auditors in a multi-tiered audit arrangement. In many instances, first other auditors are located closer geographically to second other auditors. The first other auditor is often more familiar with the business practices in that particular region and may have more direct relationships with management in that location than the lead auditor.

Further, several of the items the lead auditor would be required to obtain and review would be delivered at year end which, given the demands during that period of the audit, could have an unintended impact on audit quality in a multi-tiered group audit structure where multiple first other auditors are supervising second other auditors who perform work in support of the group audit opinion. As a result, we don't believe that the lead auditor should be required to obtain, review and retain the second other auditor's documentation required by AS 1215.19.

Page 31 of the Supplemental Request says, "The lead auditor would remain responsible for obtaining, reviewing, and retaining information described in AS 1215.19, and would have additional requirements for obtaining and reviewing documentation as discussed in Section III.B.4 of this release." We are not sure what those additional requirements are. Section III.B.4 discusses certain items (e.g., directing the other auditor to provide for review specified documentation of its work) which proposed paragraph .B2 of AS 1201 would allow the lead auditor to direct the first other auditor to perform. As a result, page 31 seems to contradict the information outlined in paragraph .B2.

We recommend the Board also consider allowing the lead auditor to direct the first other auditor to perform the procedures in proposed paragraph .B6 of AS 2101 such as understanding the knowledge, skill and ability of other auditors, and the responsibilities in proposed paragraph .B4 of AS 2101 regarding independence and ethics requirements. The first other auditor will most likely be in the best position to perform these procedures, such as evaluating the knowledge, skill and ability of the second other auditor based on its direct interactions with the second other auditor. Furthermore, the second other auditor would need to consider the knowledge obtained from these procedures in determining the extent of involvement needed to properly supervise the second other auditors.

Other matters

Proposed Appendix A of AS 1105, Audit Evidence – Proposed Auditing Standard – Auditing Accounting Estimates, Including Fair Value Measurements, and Proposed Amendments to Certain PCAOB Auditing Standards

The requirements currently outlined for other auditors in the Proposal overlap with certain requirements in paragraphs .A4 and .A5 of Proposed Appendix A in the PCAOB's *Proposed Auditing Standard – Auditing Accounting Estimates, Including Fair Value Measurements, and Proposed Amendments to Certain PCAOB Auditing Standards* issued under PCAOB Rulemaking Docket Matter No. 43 (collectively, the estimates proposal). Paragraph .A4a of proposed Appendix A of AS 1105 requires that the auditor obtain and evaluate information about the professional reputation and standing of the investee's auditor. It is unclear whether the procedures the auditor performs to evaluate the professional reputation of the other auditor are limited to those in proposed paragraph .A4a of AS 1105 of the estimates proposal or the auditor would need to perform all procedures in proposed paragraph .B6 of AS 2101 of the Proposal to evaluate the knowledge, skill and ability of the investee's auditor.

Additionally, paragraph .A4b of proposed Appendix A of AS 1105 would require the auditor to obtain information about the procedures the investee's auditor performed and the results thereof or review the audit documentation of the investee's auditor. It is unclear whether the procedures the auditor would perform are limited to those described in proposed paragraph .A4b of AS 1105 of the estimates proposal or if the auditor would also be required to obtain the documentation in proposed paragraph .B4 of AS 1201 in the Proposal.

We believe that further clarity is needed about whether the requirements in the estimates proposal are consistent with the requirements in the Proposal or whether additional procedures would be necessary. We believe the PCAOB should consider the requirements for an other auditor in the Proposal in conjunction with the requirements for an other auditor in the estimates proposal to avoid any unintended consequences.

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

The Supplemental Request proposes revisions that would allow the lead auditor to divide responsibility with another accounting firm when the company and a business unit audited by another auditor prepare their financial statements under different financial reporting frameworks. In these situations, the auditor's report would need to indicate which auditor is responsible for auditing the conversion adjustments. We suggest that the PCAOB revise the example reports provided in paragraph .B1 of proposed AS 1206 to clarify which auditor is responsible for auditing internal controls over those same conversion adjustments.

Summary review memorandum equivalency to engagement completion document

We suggest that the PCAOB clarify whether the summary memorandum as described in proposed paragraph .B2d of AS 1201 is equivalent to the engagement completion document required by existing AS 1215.19a. If the summary review memorandum is, in fact, equivalent to an engagement completion document, proposed paragraph .B2d of AS 2101 is not needed in the final standard.

Registration status of other auditors

The Board has enhanced the transparency of other auditor's participation in the audit through its issuance of PCAOB Rule 3211, *Auditor Reporting of Certain Audit Participants*. The adoption of that rule provided a simple and practical determination to evaluate the significance of an other auditor's participation in the audit by recognizing the complexities of global network firms. The focus on Rule 3211 highlighted some of the challenges related to the language in 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."

We believe the Board now has the opportunity to promote greater consistency between Rule 2100 and Rule 1001(p)(ii) and make those measures consistent with those disclosed to investors on Form AP about the importance of other auditor participation in the audit. We encourage the Board to take advantage of this opportunity by conforming the determination of substantial role using the same approach used for disclosures now made to the public. We suggest that the PCAOB make certain modifications to Rule 2100 and Rule 1001(p)(ii) to require that substantial role be defined as any auditor whose participation in the audit, as determined using the requirements in Rule 3211, is 20% or more of total audit hours and challenge whether the other criteria are needed.

Referred-to-auditors – sufficiency criterion

The Supplemental Request also proposed adding a sufficiency criterion to be met by the lead auditor in divided responsibility engagements. The Board clarified that the threshold was analogous to the quantitative threshold that appears in the staff guidance in the Financial Reporting Manual (FRM) of the SEC Division of Corporation Finance. While we do not believe this addition is necessary, we suggest that the PCAOB revise the language for the sufficiency criterion in proposed paragraph .B2b of AS 2101 to be similar to that of the Section 4140.1 of the FRM, as follows:

Generally, the lead auditor is expected to have audited or assumed responsibility for reporting on at least 50% of the assets and revenues of the consolidated entity.

The determination of the lead auditor can be judgmental based on unique facts and circumstances. For these reasons, we do not believe there should be a bright line quantitative requirement.

Definitions – lead auditor

In our previous comment letter, our firm requested further clarification of the lead auditor definition. In the Supplemental Request, the Board clarified the lead auditor definition in its commentary, but not in the proposed amendments. We suggest that the PCAOB add a footnote to the lead auditor definition (in proposed paragraph .A4 of AS 2101, proposed paragraph .A4 of AS 1201, and paragraph .A2 of proposed AS 1206) of the final standard to clarify that individuals working under the lead auditor's guidance and control (such as secondees from other accounting firms, employees of shared service centers and other individuals who work in the role of firm employees) should be treated as employees of the lead auditor's firm.

Definitions – other auditor

The Proposal would require the lead auditor to determine each other auditor's compliance with SEC independence requirements and PCAOB independence and ethics requirements. In the Supplemental Request, the Board clarified how the proposed other auditor definition might apply to both a firm and individuals from that firm. We suggest that the PCAOB include footnotes to the other auditor definition in the final standard that are consistent with footnote 20 in the commentary on page 12 of the Supplemental Request to clarify in other areas of the Proposal whether the other auditor definition is applied at the firm level or to individuals at that firm.

Other considerations

We note that our view on the following topics remain consistent with those we expressed in our July 2016 comment letter on the PCAOB's initial proposal on supervision of other auditors:

- ▶ *Engagement quality reviewer* – The Board stated that although determining the sufficiency of a firm's participation might not always be difficult or complicated, the decision that the firm can serve as lead auditor is a significant judgment because it affects whether the firm can issue the auditor's report. We continue to believe the engagement quality reviewer's evaluation of sufficiency of participation would not always be a significant judgment under AS 1220 and therefore should not always be required.



- ▶ *Interfirm reporting* – We continue to believe that reporting provided by the other auditor to the lead auditor plays a significant role in communicating responsibilities and further guidance on the format of reports provided by other auditors would promote consistency in practice.

Effective date

Because the proposed changes would affect the planning for audits, teams must be prepared to adopt the standard at the beginning of an audit cycle. Given the expected effort required to implement the Proposal, we believe firms would need at least 18 months between SEC approval and the beginning of the fiscal year in which it is effective to implement a sufficient framework to adequately comply with the final standard. As a result, we recommend that the standard be effective for audit periods beginning two years after the SEC approves the final standard, or, if the SEC approval occurs in the third or fourth quarter, for audits of fiscal years beginning three years after the year of SEC approval.

* * * * *

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

Very truly yours,

Copy to:

PCAOB

James R. Doty, Chairman
Lewis H. Ferguson, Board Member
Jeanette M. Franzel, Board Member
Steven B. Harris, Board Member
Martin F. Baumann, Chief Auditor and Director of Professional Standards

SEC

Jay Clayton, Chairman
Kara M. Stein, Commissioner
Michael S. Piwowar, Commissioner
Wesley R. Bricker, Chief Accountant
Marc A. Panucci, Deputy Chief Accountant

November 6, 2017

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

Electronically submitted: comments@pcaobus.org

Re: PCAOB Rulemaking Docket Matter No. 042: Supplemental Request For Comment:
Proposed Amendments Relating To The Supervision Of Audits Involving Other Auditors And
Proposed Auditing Standards—Dividing Responsibility For The Audit With Another Accounting
Firm

Dear Ms. Brown:

The Accounting Principles and Auditing Standards Committee (the Committee) of the Florida Institute of Certified Public Accountants (FICPA) respectfully submits its comments on the referenced proposal. The Committee is a technical committee of the FICPA and has reviewed and discussed the above referenced proposed amendment and proposed standard issued by the Public Company Accounting Oversight Board (the PCAOB). The FICPA has more than 20,000 members, with its membership comprised primarily of CPAs in public practice and industry. The Committee is comprised of approximately 23 members, of whom 48% are from local or regional firms, 26% are from large multi-office firms, 13% are sole practitioners, 9% are in international firms, and 4% are in education.

The Committee fully agrees with the Board's objectives to strengthen the existing requirements and impose a more uniform approach to the lead auditor's supervision of other auditors, as described in the proposed standard and appreciate the Board's efforts in this area. Overall there was general agreement with the proposed auditing standard; however, the Committee would also like to include responses to the questions.

Inspection Deficiency Rates

During the review of the Supplemental Request and initially released PCAOB Release No. 2016-002 dated April 12, 2016, the Committee discussed the circumstances resulting in the Proposed Amendments and Revisions. One of those cited in the original proposal is that over the past several years, PCAOB Inspections Staff have observed significant audit deficiencies in the work performed by other auditors. For example, in 2013, PCAOB Inspections Staff identified significant audit deficiencies in more than 40 percent of the inspected work performed for lead auditors by non-U.S. Global Network Firms. One Committee member commented that the

aforementioned deficiency rate has not been markedly different from the deficiency rate found on all PCAOB inspections.

In *Inspection Observations Related to PCAOB "Risk Assessment" Auditing Standards (No. 8 through No. 15)*, PCAOB Release No. 2015-007 October 15, 2015, it is reported that audit deficiencies were found by PCAOB Inspections Staff in 227 (or 27 percent) of the 848 audits inspected in 2013 and in 165 (or 26 percent) of the 632 audits inspected in 2012. Although, the deficiency rate in all audits is somewhat less than the deficiency rate in audit work performed for lead auditors by other auditors, the results are comparable.

Implementation Costs

The Committee discussed the implementation costs whereby several Committee members who are from large national and global accounting firms noted that although there could be some implementation costs, the expected incremental cost and effort to implement the proposed amendments and revisions would not be significant since their firms were already performing and documenting the procedures consistent with the new requirements.

1) Response to Question 1

The Committee believes the revised requirement for determining the sufficiency of participation to serve as lead auditor, based on risk and importance of the locations is appropriate and clear.

2) Response to Question 2

This question is a supplemental request for comment related to the *Proposed Auditing Standard—Dividing Responsibility for The Audit With Another Accounting Firm*. In the original PCAOB Release No. 2016-002 April 12, 2016 (Page 9), the PCAOB states “Those ‘divided responsibility’ situations are relatively uncommon.” Also in the original release, footnote 42 indicates that there were 50-60 audits in each of fiscal years 2014 and 2013 in which the lead auditor divided responsibility. Footnote 7 of the original release indicates that there were 8,606 public companies trading in the U.S. in 2015. These figures indicate that the situation of divided responsibility occurs in less than 1% of public company audits. The Committee’s experience mirrors the PCAOB’s observation that divided responsibility is uncommon. None of the Committee members have been on an engagement team that “divided responsibility on a public company audit” and as such the Committee has declined comment to this question.

3) Response to Question 3

- a. The Committee believes the revised requirements relating to the other auditors' compliance with the independence and ethics requirements is appropriate.
- b. The Committee also believes there are no practical challenges associated with the revised amendments.

- c. Since the Committee believes there are no practical challenges associated with the revised amendments, the Committee also believes that no further revisions of the proposed requirements are necessary.

4) Response to Question 4

- a. The Committee believes the proposed amendments relating to the knowledge, skill, and ability of the other auditor, revised by this release, are appropriate.
- b. The Committee also believes there are no practical challenges associated with the revised amendments.
- c. Since the Committee believes there are no practical challenges associated with the revised amendment, the Committee also believes that no further modification of the proposed requirements are necessary.

5) Response to Question 5

- a. The Committee believes the proposed new addition to AS 1015 *Due Professional Care in the Performance of Work*, and revision to AS 1201 *Supervision of the Audit Engagement* relating to the other auditors' responsibility are appropriate and clear.
- b. This question is related to audits that divide responsibility. The Committee declines to comment on this question for the reasons provided in our response to Question 2.

6) Response to Question 6

- a. The Committee believes the proposed new additions to AS 1201.B2, *Reviewing the Other Auditor's Work* are appropriate and clear.
- b. The Committee also believes it is clear that the necessary level of detail of the other auditor's audit documentation that the lead auditor obtains and the necessary extent of the lead auditor's review according to requirements in proposed Appendix B of AS 1201 are scalable based on the factors in the existing standard regarding the necessary extent of supervision.

7) Response to Question 7

- a. The Committee believes the revised proposed requirements for situations in which the lead auditor directs another auditor to perform supervisory procedures with respect to a second other auditor on behalf of the lead auditor is clear.
- b. Since the Committee believes the revised proposed requirements are clear, there is no need for further revisions.

8) Response to Question 8

- a. This question is related to audits that divide responsibility. The Committee declines to comment on it for the reasons provided in the response to Question 2.

9) Response to Question 9

- a. The Committee declines to comment on whether or not it is clear how the proposed amendments and new standard (as revised by this release) relate to other amendments to auditing standards proposed or adopted by the Board since the 2016 Proposal given limited involvement of sufficient Committee members with other proposed or adopted standards to permit adequate dialogue and comment.

10) Response to Question 10

- a. The Committee believes that the revisions the Board is considering for adoption do not affect the scalability of PCAOB standards in this area since the proposal and revisions use a risk-based supervisory approach.
- b. The Committee believes that the revisions the Board is considering for adoption will not have a significant effect on the competitiveness of smaller audit firms because, in general, the requirements of the proposal and revision are not expected to be restrictively time consuming and that smaller firms rely on practice aids that will incorporate the new requirements and allow the practitioner to perform an efficient and cost-effective audit.
- c. The Committee believes the revisions will not significantly change the costs and benefits associated with the proposed changes discussed in the 2016 Proposal.
- d. The Committee believes that an unintended consequence that the Board should consider is that there may be an increase in “divided responsibility” audits. Firms may decide after studying the voluminous proposal (202 pages), the revisions (94 pages), the original 26 comments, and additional comments submitted for the revisions, that it is more efficient for the firm to divide responsibility (Proposed AS 1206), which has fewer requirements and may be expected to take less effort, than to supervise the other auditor and take responsibility for the other auditor’s work (AS 1201).
- e. The Committee believes there are no other matters not addressed in this release that the Board should consider in its economic analysis.

Response to Question Regarding Emerging Growth Companies (EGCs)

- a. The Committee is not aware of any available empirical data related to the revisions discussed in this release and the potential impact on EGCs.
- b. The Committee believes that the revised proposal would not have an impact on protecting investors and promoting efficiency, competition, and capital formation since many EGC investment decisions are made based on information outside of historical audited financial statements such as: patents pending expected to be approved; successful clinical trials; expected introduction of breakthroughs in software, hardware, and mobile applications; recruitment of senior executives from

other successful firms; and hedge funds and financial institutions obtaining a major stake or increasing their holdings in the EGC. In addition, as noted in the Committee's response to Question 2 as well as in the previously issued PCAOB Release No. 2016-002 April 12, 2016 (Page 50), "EGCs – a majority of which are smaller companies – are significantly less likely to operate in multiple countries" and as such the Committee would expect both the division of responsibility as well as supervision of other auditors to be even more limited with EGCs.

Response to Question Regarding Broker Dealers

- a. The Committee declines to comment on this question with respect to audits of brokers and dealers because, although, several of the Committee members perform broker dealer audits, none of these audits involve other auditors, and therefore, the Committee does not have relevant experience to form the basis for a response.

Effective Date

- a. The Committee believes that one year is sufficient for the proposed new auditing standard and amendments to become effective, if adopted by the Board and approved by the SEC.
- b. The Committee also believes that the adopted standard and amendments should be required for audits of fiscal years beginning in the year 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).

The Committee appreciates this opportunity to respond to the proposed auditing standards. Members of the Committee are available to discuss any questions or concerns raised by this response.

Respectfully submitted,
 Steven Bierbrunner, CPA
 Chair, FICPA Accounting Principles and Auditing Standards Committee

Committee members coordinating this response:
 Bruce H. Nearon, CPA



November 15, 2017

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Re: PCAOB Rulemaking Docket Matter No. 042, *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Accounting Firm*

Dear Board Members and Staff:

Grant Thornton LLP appreciates the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or Board) Supplemental Request for Comment (SRC) on the *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Accounting Firm*. We continue to support this project and commend the Board for furthering its outreach on this topic in order to inform amendments and the related standard that will drive high-quality audits. We are generally supportive of the revisions proposed in the SRC and respectfully submit our comments on the areas that may benefit from further refinement.

Sufficiency of participation

We are generally supportive of the proposed revisions to paragraph .B2 of Auditing Standard (AS) 2101, *Audit Planning*. The changes provide for a more risk-based approach to determining sufficiency of participation. They also make the proposed requirement more consistent with the principles within the extant requirement in paragraph .02 of AS 1205, *Part of the Audit Performed by Other Independent Auditors*, and we believe there is a general understanding and execution regarding the "importance" of components in performing risks assessment and designing further audit procedures. Thus, we would not anticipate significant operational challenges in implementing the revised proposed requirement.

We question, however, whether the Board's addition of language related to the 50 percent threshold brings a new or alternative meaning to the current SEC guidance with respect to evaluating participation. We are concerned the proposed revision creates a rebuttable presumption rather than providing a general guideline. Therefore, we recommend using

language similar to what exists in Section 4140.1 of the *Financial Reporting Manual* of the SEC Division of Corporation Finance in paragraph .B2 of AS 2101, marked for changes, as follows:

~~In addition, the participation of the engagement partner's firm to serve as lead auditor ordinarily is not sufficient if the referred to auditors, in aggregate, audit more than 50 percent of the company's assets or revenues. Generally, the lead auditor is expected to have audited or assumed responsibility for reporting on at least 50% of the assets and revenues of the consolidated entity.~~

Other auditors' compliance with independence and ethics

While we appreciate the increased clarity provided by the proposed revisions to paragraph .B4 of AS 2101, we have considerable concerns with the resulting proposed requirements. We believe these requirements could create operational challenges as well as introduce undue cost into the system. Requiring the lead auditor to gain an understanding of each other auditor's processes represents a significant change from current practice. We believe the proposed requirement would result in a significant duplication of effort among many engagement teams. Additionally, there may be practical challenges related to data privacy and confidentiality restrictions, especially in certain foreign jurisdictions or if the lead auditor is using an other auditor that is not part of the lead auditor's global network. Overall, we foresee the costs and challenges of the proposed revisions outweighing the perceived benefit of enhancing procedures in this area for every engagement where this situation is applicable.

We acknowledge that there may be instances where the lead auditor determines that obtaining an understanding of the other auditor's policies and procedures is appropriate in the circumstances, for example, if the lead auditor plans to use an audit firm with which the lead auditor has no previous experience or the firm is not well established in a certain geography or jurisdiction. However, we do not agree with creating a presumptively mandatory requirement to obtain such information for each engagement.

We continue to believe that the written representations play an important role in evaluating the other auditor's independence, and that the representations should not be diminished by creating a framework that could result in a lengthy, burdensome administrative exercise. To address these concerns, we recommend amending AS 2101 as follows:

.B4 In an audit that involves other auditors, the lead auditor should confirm ~~determine~~ each other auditor's compliance with the SEC independence requirements and PCAOB independence and ethics requirements by obtaining from each other auditor:

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

~~b. Obtaining from each other auditor:~~

~~a. (1) 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; and~~

~~b. (2) A written representations of the following:~~

~~(1) That the other auditor is, or is not, in compliance with SEC independence requirements and PCAOB independence and ethics requirements and, if it is not, a description of the nature of any noncompliance; and~~

~~(2) That the other auditor has appropriate policies and procedures in place in assessing compliance with SEC independence requirements and PCAOB independence and ethics requirements, including consideration of matters that may reasonably be thought to bear on independence.~~

Note: If the lead auditor becomes aware of information during the course of the audit that contradicts an other auditor's ~~description of its relationships that may reasonably be thought to bear on independence or a written representation made by an other auditor~~ regarding its compliance with the SEC independence requirements and PCAOB independence and ethics requirements, or the appropriateness of its policies and procedures, the lead auditor should perform additional procedures to determine the effect of such information on the independence of the other auditor.

Use of network firms

In our letter dated July 29, 2016, we indicated that “we believe the lead auditor should have the ability to consider and, when appropriate, rely on a network firm’s system of quality control in determining the nature and extent of the assessment.” We acknowledge the Board’s consideration, and ultimate rejection, of “relying” on network firms’ systems of quality control relative to verifying independence and ethics. However, currently, a network of firms generally has baseline policies related to independence and ethics to which each network firm is expected to adhere, and such policies are subject to regular inspection through the network’s system of quality control. We believe that those baseline policies, coupled with the results of inquiries and the representations provided by the network firm indicating compliance with the appropriate independence and ethical frameworks and network policies, are suitable and sufficient for lead auditor purposes. Not including a note or other acknowledgment specific to the use of global network policies and procedures may be viewed as a considerable change in what is acceptable practice for firms with international networks. We believe that this could result in uncertainty with respect to the appropriate reliance on network firms and potentially result in significantly increased administrative cost on firms that utilize their global networks, with no further benefit to audit quality.

Other auditors' knowledge, skill, and ability

We agree that consideration of the other auditor's knowledge, skill, and ability is important in determining the appropriate level of supervision needed by the lead auditor. Nevertheless, we do not agree with the proposed revisions to paragraph .B6a. We believe the proposed revisions could create the same operational challenges and introduction of undue cost related to the independence, as discussed in the section above. We do not see a significant benefit to audit quality in requiring the lead auditor to obtain an understanding of the other auditors' policies and procedures relative to assignments and training. Rather, we believe the focus should remain on the specific individuals who are assigned to the lead auditor's engagement, since that will have the most direct impact on the lead auditor's determination of the nature and extent of its supervision of the other auditor. Therefore, we encourage the Board to reject the proposed revision to paragraph .B6a and retain the language as originally proposed.

Further, we recommend that the Board insert a note after this paragraph to include the notion that the lead auditor's own experience working with the other auditor is relevant to the lead auditor's understanding of the knowledge, skill, and ability of relevant personnel. This guidance, as acknowledged on page 16 of the SRC, would be helpful in assisting auditors to better understand how to apply the requirements of the standard with regard to other auditors.

Written reports

We appreciate the staff's proposed revision from requiring a written report to requiring a summary memorandum in AS 1201, *Supervision of the Audit Engagement*. We agree that the form of final communication will depend on the facts and circumstances of each engagement and believe this provides appropriate flexibility for the lead auditor to determine what is sufficient and appropriate. However, it is unclear how the summary memorandum described in proposed paragraph .B2d interacts with the engagement completion document required by paragraph .19 of AS 1215, *Audit Documentation*.

We believe there may be instances whereby the other auditor's documentation provided in accordance with AS 1215.19 would be sufficient for the lead auditor's purposes. We ask the Board to clarify if there are certain situations where a lead auditor may not need to obtain specified documentation beyond the requirements in AS 1215.19. As currently drafted, we foresee potential duplication of efforts or documentation exercises that is not risk-based in other auditors' efforts to comply with both AS 1215.19 and portions of proposed AS 1201.B2. We recommend that the Board further consider the interaction between these two paragraphs to determine what would be the most beneficial approach to audit quality and effectiveness.

Effective date

We continue to believe that audit firms will need sufficient time to develop and implement policies and quality control processes and to provide adequate communication to its network firms. Since planning for large, international engagements begins very early in the audit process, we strongly recommend making the proposed standard and

amendments effective for audits of fiscal years beginning two years after approval by the SEC or, if SEC approval occurs in the third or fourth quarter, fiscal years beginning three years after the year of SEC approval.

We would be pleased to discuss our comments with you. If you have any questions, please contact Bert Fox at (312) 602-9080 or Bert.Fox@us.gt.com, or Trent Gazzaway at (704) 632-6834 or Trent.Gazzaway@us.gt.com.

Sincerely,





November 15, 2017

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
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Re: PCAOB Rulemaking Docket Matter No. 042

Dear Board Members:

The Audit and Assurance Services Committee of the Illinois CPA Society (“Committee”) is pleased to comment on the PCAOB’s 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* (Docket Matter No. 42), dated September 26, 2017. The organization and operating procedures of the Committee are reflected in the attached Appendix A to this letter. These comments and recommendations represent the position of the Illinois CPA Society rather than any members of the Committee or of the organizations with which such members are associated.

GENERAL COMMENTS:

As a Committee, we agree with efforts made by the PCAOB and believe the proposed amendments to AS 1205 as well as the new proposed auditing standard AS 1206 are needed to help drive audit quality. The Committee also believes the revisions proposed in the supplemental request for comment provided additional clarity to the proposed amendments, and appreciates the PCAOB’s responsiveness to comments submitted with the initial proposed amendments.

For reference, our response to the original proposed amendments dated April 12, 2016 are attached to this letter (see Appendix B).

Our response to the supplemental request for comment is limited to the following question.

PCAOB QUESTIONS:

Question 3:

Are the revised requirements relating to the other auditors’ compliance with the independence and ethics requirements appropriate? Are there any practical challenges associated with the revised amendments? If so, what are they, and how could the proposed requirements be revised to address the challenges?

Response:

We believe the proposed amendments surrounding gaining an understanding of the other auditor(s) knowledge of the SEC and PCAOB independence and ethics requirements, and their experience in applying the requirements are prudent. However, we believe the revised requirements relating to the other auditors’ compliance with the independence and ethics requirements would create an undue burden on the lead auditor, in particular when the other auditor is not part of the lead auditor’s network. Some out-of-network other auditors might be reluctant to provide the lead audit firm with details regarding local independence, ethics, or training. In addition, there could be scenarios



when additional costs and challenges are incurred, particularly if the other auditor(s) do not meet appropriate independence and ethics requirements. Or, there could be situations in which there are no viable other auditor(s) located in or near the city of the entity being covered by the other auditor, thereby requiring the lead auditor to perform the audit.

The Illinois CPA Society appreciates the opportunity to express its opinion on this matter. We would be pleased to discuss our comments in greater detail if requested.

Sincerely,

James R. Javorcic, CPA
Chair, Audit and Assurance Services Committee

Scott Cosentine
Vice Chair, Audit and Assurance Services Committee



ILLINOIS CPA SOCIETY

APPENDIX A

AUDIT AND ASSURANCE SERVICES COMMITTEE
ORGANIZATION AND OPERATING PROCEDURES
2017 – 2018

The Audit and Assurance Services Committee of the Illinois CPA Society (Committee) is composed of the following technically qualified, experienced members. The Committee seeks representation from members within industry, education and public practice. These members have Committee service ranging from newly appointed to almost 20 years. The Committee is an appointed senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of audit and attestation standards. The Committee's comments reflect solely the views of the Committee, and do not purport to represent the views of their business affiliations.

The Committee usually operates by assigning Subcommittees of its members to study and discuss fully exposure documents proposing additions to or revisions of audit and attestation standards. The Subcommittee develops a proposed response that is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times includes a minority viewpoint. Current members of the Committee and their business affiliations are as follows:

Public Accounting Firms:**National:**

Timothy Bellazzini, CPA	Sikich LLP
Todd Briggs, CPA	RSM US LLP
Scott Cosentine, CPA	Ashland Partners & Company LLP
Heidi DeVette, CPA	Johnson Lambert LLP
James J. Gerace, CPA	BDO USA, LLP
Michael R. Hartley, CPA	Crowe Horwath LLP
James R. Javorcic, CPA	Mayer Hoffman McCann P.C.
John Offenbacher, CPA	Ernst & Young LLP
Michael Rennick	Grant Thornton LLP
Elizabeth J. Sloan, CPA	Grant Thornton LLP
Richard D. Spiegel, CPA	Wipfli LLP
Kevin V. Wydra, CPA	Crowe Horwath LLP

Regional:

Jennifer E. Deloy, CPA	Marcum LLP
Michael Ploskonka, CPA	Selden Fox, Ltd.
Genevra D. Knight, CPA	Porte Brown LLC
Andrea L. Krueger, CPA	CDH, P.C.

Local:

Arthur Gunn, CPA	Arthur S. Gunn, Ltd.
Lorena C. Johnson, CPA	CJBS LLC
Mary Laidman, CPA	DiGiovine, Hnilo, Jordan & Johnson, Ltd.
Carmen F. Mugnolo, CPA	Mugnolo & Associates, Ltd.
Jodi Seelye, CPA	Mueller & Company LLP
Joseph Skibinski, CPA	



Industry/Consulting:

Sean Kruskol, CPA

Cornerstone Research

Educators:

David H. Sinason, CPA

Northern Illinois University

Staff Representative:

Heather Lindquist, CPA

Illinois CPA Society



APPENDIX B

July 29, 2016

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: PCAOB Rulemaking Docket No. 042

Dear Board Members:

The Audit and Assurance Services Committee of the Illinois CPA Society (“Committee”) is pleased to comment on the PCAOB’s Proposed Amendments Relating to the *Supervision of Audits Involving Other Auditors and Proposed Auditing Standard - Dividing Responsibility for the Audit with Another Accounting Firm* (Docket Matter No. 42), dated April 12, 2016. The organization and operating procedures of the Committee are reflected in the attached Appendix A to this letter. These comments and recommendations represent the position of the Illinois CPA Society rather than any members of the Committee or of the organizations with which such members are associated.

GENERAL COMMENTS:

As a Committee, we agree with efforts made by the PCAOB and believe the proposed amendments to AS 1205 as well as the new proposed auditing standard AS 1206 are needed to help drive audit quality. Our response is limited to the following questions.

PCAOB QUESTIONS:

Question 1:

Does the description of existing audit practice accurately depict the state of practice? Does the discussion of the reasons to improve auditing standards sufficiently describe the nature of concerns arising from the use of other auditors that the Board should address? Are there additional concerns that the Board should seek to address?

Response:

We believe the description of existing audit practice is accurate. We also believe that the discussion of the reasons to improve auditing standards as it relates to the Use of Other Auditors sufficiently describes the current nature of concerns the Board should address. The original standard was issued in 1979 and updated in 1996, however, with the increase in corporate globalization and the use of other auditors, this amendment should improve audit quality.

Question 2:

Are these proposed amendments to existing standards appropriate? Are additional changes needed to increase the likelihood that the lead auditor is sufficiently involved in the other auditor's work? Should the Board require specific procedures to address business, language, cultural, and other differences between lead auditors and other auditors, and if so, what types of procedures?



Response:

Yes, we believe the proposed amendments are appropriate and should improve audit quality. We believe the changes to increase the lead auditor's involvement are appropriate.

Question 6:

The Board requests comment generally on the potential benefits to investors and the public. Are there additional benefits the Board should consider?

Response:

We believe the proposed amendments will provide more transparency when using other auditors and will, therefore, benefit investors and the public.

Question 8:

The Board requests comment generally on the potential unintended consequences of the proposal. Are the responses to the potential unintended consequences discussed in the release adequate? Are there additional potential unintended consequences that the Board should consider? If so, what responses should be considered?

Response:

We believe there could be other unintended consequences beyond what is discussed in the proposed standard. For example, if the lead auditor does not have a network firm in a particular country and needs to consider the use of the statutory auditor in the audit; if the statutory auditor is not registered with the PCAOB, the lead auditor may need to send his/her engagement team to the country to complete the audit. These additional procedures could increase the cost of the audit.

Question 9:

Could the proposed requirement for lead auditor supervision diminish (or be perceived as diminishing) the other auditor's accountability for the work the other auditor performs? If so, are any changes to the proposal needed to describe the other auditor's responsibilities?

Response:

Typically, the lead auditor will ask the other auditor to issue a "report", so we would not say it diminishes the "other auditors" accountability over their own work. From the Board's release, you have seen evidence that with increased supervision and direction given to the other auditor, there was an increase in the quality of their work. We believe the perception would be that the other auditor's work would improve due to the increased supervision by the lead auditor.

Question 10:



Could the proposed requirement for lead auditor supervision induce lead auditors in some audits to divide responsibility with another accounting firm rather than supervise the accounting firm? If so, how often might this division of responsibility occur?

Response:

Yes, if the other firm is a great distance apart and close supervision cost-prohibitive, this could induce the lead auditor to divide responsibility, by referring to the other auditor in their report. In addition to being cost prohibitive, there is also the matter of completing all the work to a strict deadline. The lead auditor may physically not be able to do all their work here in the US, “closely supervise” firms in other countries and still meet strict deadlines. If the lead firm is already performing additional procedures, they are less likely to divide responsibility.

Question 14:

The Board requests comment generally on the analysis of the impacts of the proposal on audits of brokers and dealers. Are there reasons why the proposal should not apply to audits of brokers and dealers? Are there any factors specifically related to audits of brokers and dealers that should affect the application of the proposal to those audits?

Response:

We believe that Brokers and Dealers should follow the same standards as issuers.

Question 16:

Are the proposed definitions of: (a) "engagement team," (b) "lead auditor," (c) "other auditor," and (d) "referred-to auditor" appropriate? Do the proposed definitions clearly describe individuals and entities that are included in these definitions? Is it clear which individuals or entities are not included in these definitions? If not, what changes to the proposed definitions are necessary?

Response:

Yes. See question #17, for specific revision to “lead auditor”

Question 17:

Some global network firms use short-term (several months) personnel sharing arrangements, during which some available personnel are seconded to other firms and function as their employees. Some firms contract with consulting firms or temporary workforce agencies for personnel that work alongside and in the same capacity as personnel on the engagement team that are employed by the lead auditor. Should these personnel be treated as part of the lead auditor?

Response:

Yes, if these personnel are supervised by the lead auditor, working out of their location, and their work is reviewed by the lead auditor, these team members should be treated as personnel of the lead auditor. Page A1-21, Appendix A .A3, a (1), uses the phrase: “professional staff employed or engaged by”. It may be helpful to include a footnote to explain the breadth of the meaning of the term “other auditor”, as explained in your question.

Question 19:



Should there be requirements for the lead auditor to: (1) specifically identify the engagement team members responsible for assisting the engagement partner of the lead auditor in fulfilling his or her supervisory responsibilities and (2) document such assignments? Should the individuals who assist the engagement partner with supervision be limited to engagement team members from the office issuing the auditor's report?

Response:

Yes, documentation should include engagement team members and their roles in the engagement. The office issuing the report should not be required to be the only office “supervising” staff in other countries. “Supervision” is a broad term, and we believe it also covers direct supervision in that country. The lead auditor could also “remotely supervise” by other means which includes direct review of high risk area work papers.

Question 20:

To emphasize the importance of assigning the proposed planning and supervision requirements to personnel with the appropriate qualifications in audits involving other auditors, the proposed definition of "lead auditor" references existing standards that describe making appropriate assignments of engagement responsibilities. Does this reference appropriately address the responsibility to seek planning and supervision assistance from qualified engagement team members in these situations?

Response:

This question was deemed to have a certain element of ambiguity. Specifically, it’s unclear whether the Board is seeking comment on situations in which the engagement partner assigns planning or supervisory requirements to an individual within his or her firm to bridge language or cultural differences or whether it’s specific to the engagement partner’s direct oversight of other auditors.

If the former, then we advise the following:

The definition or its footnotes should include discussion of the lead auditor engagement partner’s need to consider the assignee’s requisite familiarity with the industry in which the company operates, as well as the language and cultural norms of the other auditor.

We feel this clarification is necessary to ensure an engagement partner identifies resources within his or her firm that are not only proficient in the local language and cultural norms, but also familiar with accounting issues and audit risks within the relevant industry to be able to identify and communicate deficiencies to the engagement partner.

If the latter, then we advise the following:

Paragraph .B6 in Appendix B (Page A1-14 of Release No. 2016-002) should either be referenced or incorporated into the definition of lead auditor. In other words, we feel the definition should be clear with respect to the engagement partner’s need to consider the other auditor’s experience in the industry in which the company operates, as well as their knowledge of the relevant financial reporting framework, PCAOB standards and rules, SEC rules and regulations, and their experience in applying the standards, rules, and regulations. The engagement partner should also determine whether he or she can adequately communicate with the other auditors and/or gain access to their work papers.



Regardless of the Board's intent with this question, we feel clarification is warranted within the proposed definition of "lead auditor" to further reinforce the consideration of language and cultural norms inherent in any audit which includes other auditors.

Question 21:

The proposed requirements for determining whether a firm's participation is sufficient for it to serve as the lead auditor depend on the risks of material misstatement associated with the portion of the financial statements audited by the firm. (These requirements would apply regardless of whether the other auditor is from the same audit network as the lead auditor.) Should the Board consider alternative or additional criteria for determining whether a firm's participation is sufficient? For example, should the Board impose a quantitative threshold or specify criteria covering the locations of the company's principal assets, principal operations, or corporate offices? How would such criteria help address specific issues in practice?

Response:

The firm's consideration of its direct audit coverage over the risks of material misstatement appears an appropriate determination for evaluating the sufficiency for the firm to serve as lead auditor. The proposed language appears intentionally broad so as to allow for the many varying situations and circumstances, as well as variables that are considered in such a determination, and appropriately allows for auditor judgment in its final assessment.

While the Board could consider offering additional criteria for auditor consideration when making this determination, we feel that if the language is too specific (which can arise when quantitative thresholds are added) it can restrict appropriate analysis of the qualitative factors involved when making such a determination. If a coverage threshold requirement of a certain level of locations, total assets or revenue is communicated, an appropriate analysis of the true risks of material misstatement could be diminished. For example: there certainly could be situations where a significant portion of the company's assets may be audited by another auditor because they are located in a foreign jurisdiction due to the location of the company's manufacturing process; however the company's US based operations (covered by the lead auditor) contain significant revenue streams requiring complex accounting (multiple deliverables, licensing, etc.) and therefore house the most significant risks of material misstatement. Thus, a threshold of certain levels of assets directly audited by the lead auditor may be seen as overshadowing the consideration of the true coverage of auditing the significant risks of material misstatement.

We believe that while certain consideration language in the proposal may assist the firm in determining sufficiency, additional criteria or thresholds could result in unintended conclusions or outright violations of standards.

Question 22:

What are the practical challenges with applying the proposed engagement partner's determination of the firm's sufficiency of participation in the audit? What changes, if any, should be made to address those challenges?

Response:

The primary practical challenge with applying the proposed engagement partner's determination of the firm's sufficiency of participation in the audit lies primarily with adequate documentation of auditor judgment. Whenever leeway for auditor judgment is given, there is the potential for different applications and varying conclusions. In addition, objective judgment is obviously affected by the desire to serve as the lead auditor. However, in most areas this judgment is necessary because of the numerous variables that must be considered and also due to the fact that no situations and circumstances are exactly alike.



The Board could consider a documentation requirement where the firm qualitatively assesses the positive and negative evidence of the firm's sufficiency to serve as the lead auditor, which includes conclusion and clear basis for such a conclusion. This documentation could be prepared as part of the engagement acceptance process and maintained in the audit file.

Question 23:

Are there situations in practice in which the proposed sufficiency determination would cause changes in the firm serving as lead auditor? If so, what are these situations? What are the potential effects of those changes, including potential effects on costs and audit quality? What changes to the proposal, if any, would mitigate these issues?

Response:

As proposed, the sufficiency determination could result in changes in the firm serving as lead auditor if the current level of involvement by the lead auditor is determined to be inadequate under the new standard. This could result in increased costs incurred by the lead auditor. Particularly, if increased involvement by the lead auditor replaces work performed by local auditors, the added travel time and potentially higher rates would result in higher costs and fees. Alternatively, if a change in lead auditor is required, the company will bear the incremental costs of such a transition.

In regards to audit quality, increased involvement by lead auditors should, in theory, improve audit quality. There is the potential, however for the lead auditor to continue to limit its involvement. Due to fee pressure invoked by the company, there is the potential that the lead firm may try to keep these costs to a minimum and, as a result, not audit as thoroughly as another auditor might.

Question 25:

Are the proposed requirements for the lead auditor to hold discussions with and obtain information from other auditors and referred-to auditors to identify and assess the risks of material misstatement appropriate and clear? Are there any practical challenges with this requirement? If so, what are they, and how could the proposed requirements be revised to address the challenges?

Response:

We believe the proposed requirements for the lead auditor to hold discussions with and obtain information from other auditors and referred-to auditors are appropriate and clear, as well as prudent. The lead auditor should establish early, and maintain throughout, clear lines of communication with all other auditors participating in the audit.

Question 26:

Are the additional proposed requirements for the lead auditor when planning an audit that involves other auditors, which address independence and ethics; registration; and qualifications of and communications with other auditors, appropriate and clear? Are there requirements that should be added to or removed from Appendix B of AS 2101? If so, what are those requirements and why should they be included or excluded?

Response:

We believe the additional proposed requirements for the lead auditor when planning an audit that involves other auditors are appropriate and clear, as well as prudent. These activities should be adequately documented within the audit files.



However, we also note that some out-of-network other auditors might be reluctant to provide the lead audit firm with details regarding local independence, ethics, or training.

Question 27:

The proposed amendments require the lead auditor to gain an understanding of each other auditor's knowledge of the SEC and PCAOB independence and ethics requirements and their experience in applying the requirements. Are there any additional costs or practical challenges associated with this? If so, what are they, and how could the proposed requirements be revised to mitigate these issues?"

Response:

We believe the proposed amendments surrounding gaining an understanding of the other auditor(s) knowledge of the SEC and PCAOB independence and ethics requirements, and their experience in applying the requirements are prudent. There could be scenarios when additional costs and challenges are incurred, particularly if the other auditor(s) do not meet appropriate independence and ethics requirements. Or, there could be situations in which there are no viable other auditor(s) located in or near the city of the entity being covered by the other auditor, thereby requiring the lead auditor to perform the audit.

Question 28:

Should the requirement for the lead auditor to gain an understanding of the knowledge, skill, and ability of the other auditors be limited to engagement team members who assist the lead auditor with planning and supervision?

Response:

It seems appropriate to limit this understanding to team members who assist the lead auditor with planning and supervision, however the lead auditor should also obtain a clear understanding of the level of involvement, review and quality assurance practices of these other auditors and applicable team members. The lead auditor should take measures to ensure the vetted individuals are performing an appropriate supervisory role.

However, we also note that some out-of-network other auditors might be reluctant to provide the lead audit firm with details regarding local independence, ethics, or training.

Question 29:

Are the proposed requirements to determine that the lead auditor is able to communicate with the other auditors and gain access to their work papers appropriate and clear? If not, what changes to the proposed requirements are necessary?

Response:

The proposed requirement to determine that the lead auditor can communicate with the other auditors is clear. We recommend some additional explanatory material to clarify whether the communication needs to be written, oral, or if email communications can suffice. Due to language and time zone differences, email is a widely used communication tool and in certain situations it can appropriately serve as the correct means for a two-way dialogue. We recommend that the standard or release notes acknowledge that email communications can be acceptable.



Question 30:

Are the proposed amendments to the requirements for determining the locations and business units at which audit procedures should be performed clear and appropriate?

Response:

The language in AS 2101.14 is clear, and we agree that it allows for the lead auditor to hold discussions and obtain information “as necessary” because each situation and entity is uniquely different and will require auditor judgment to determine the correct level of information necessary. We recommend that language requiring that “the lead auditor should hold discussions with...the other auditors” be changed to “communicate” to align with practice and the other language where the audit team is required to determine that they can communicate with the other auditor instead of “discuss.”

Question 31:

Are the proposed procedures to be performed by the lead auditor with respect to the supervision of the other auditor's work appropriate and clear? If not, how should the proposed requirements be revised?

Response:

The procedures are clear, but we recommend that the requirement at AS 1201.b2b be modified to allow the lead auditor and the other auditor more flexibility in the development and review of the nature, timing and extent of audit procedures to be performed. Both parties will need information from the other in order to execute the appropriate response for the risks present, which requires a more collaborative, less linear flow of information in the audit engagement. The lead auditor may not know of the correct procedure set for the other auditor to perform until after the other auditor has already begun work based on information learned in other portions of the audit.

Question 32:

Currently, AS 1205.12 describes certain procedures that the lead auditor should consider performing when using the work of the other auditor (e.g., visiting the other auditor), which are not included in the proposal. Should the lead auditor be required to perform these or any other procedures? If so, what additional procedures should be required?

Response:

We believe there is some value in the lead auditor visiting the other auditor, but it should not be a requirement. The lead auditor, based on his/her judgment, should consider risk of material misstatement at business units audited by the other auditor to determine whether a visit is necessary.

Question 33:

Are the requirements for the written report from the other auditor sufficiently clear? Are these requirements appropriately scalable to the nature and significance of the work referred to the other auditor? Would the proposed requirement for the lead auditor to obtain a written report from the other auditor result in a significant change in practice? If so, what is the estimated economic impact (e.g., costs and benefits) of this change?

Response:



The requirement to obtain a written report, as drafted in the proposal, is not clear. Currently, in practice, there is no consistency as to what the content of the report should include. We believe, it would be helpful if the Board could provide some guidance as to what exactly this “report” is to say. For example, should the report include an opinion paragraph? We believe providing auditors with guidance will promote consistency in practice.

Question 34:

Is the scalability of the proposed supervision amendments clear and appropriate? If not, what changes are necessary? Are the proposed requirements for situations in which the lead auditor directs another auditor to perform supervisory procedures with respect to a second other auditor on behalf of the lead auditor clear? If not, how should the proposed requirements be revised?

Response:

We think allowing the lead auditor the flexibility to choose the correct supervision scenario is the most effective for an audit. The other auditor may have a better understanding and knowledge of the items the secondary other auditor is performing work over, in which case the lead auditor is not best suited to be the only reviewer. We think allowing for as much flexibility as possible will yield the greatest effectiveness in these situations.

Question 41:

The proposed requirement in AS 1215.19A is designed to provide additional information about the review of working papers performed by the lead auditor. Is the proposed requirement appropriate and clear? Why or why not? What other information about the review of the working papers performed by the lead auditor would be appropriate?

Response:

The proposed requirement for documentation is clear and appropriate. Documenting the review of other auditor work papers provides sufficient evidence of the supervision exercised by the lead auditor over other auditors. The evidence of what was reviewed, the person who reviewed the work paper and when it was reviewed is reasonable. The proposed standard indicates a description of the work papers that should be included. We would assume this description would be a brief notation as to the essence of the work paper and not a summary of the work paper. If the Board expects the description to be detailed or lengthy, we would request that this guidance be explicitly included within the standard.

Question 42:

The proposal does not require that the lead auditor make a list of all documents in the other auditor's files, including those not reviewed by the lead auditor. Should the lead auditor be required to document work papers in the other auditor's files that the lead auditor has not reviewed? Would such a requirement improve audit quality? What potential costs or unintended consequences, if any, would be associated with such a requirement? What practical difficulties would there be in complying with such a requirement?

Response:



We do not feel that audit quality would be improved nor would the benefit be significant for the lead auditor to document every work paper in the other auditor's file. The requirement in AS 1215.9A is sufficient in which it requires the lead auditor to document each work paper reviewed. However, the other auditor may have statutory audit work papers, tax work papers or other items in the audit file that are neither pertinent nor helpful to the lead auditor. We feel the cost of documenting every work paper would exceed any marginal benefit. The other auditors may have hundreds or thousands of work papers that may be performed for statutory reasons or stand-alone audit purposes that may not be material or relevant to the lead auditor. Due to these reasons, we do not believe a complete inventory of work papers included in other auditors' files need to be evidenced in the lead auditor work papers.

Question 43:

In addition to the information currently in AS 1215.19, should the office issuing the auditor's report be required to obtain, review, and retain other important information supporting the other auditor's work, e.g., (1) information about related parties or relationships or transactions with related parties previously undisclosed to the auditor or determined to be a significant risk; or (2) information about 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?

Response:

If another auditor performs audit procedures and documents significant transactions that are outside of the normal course of business or are unusual, we believe that this information should be sufficiently documented in the lead auditor's work papers. We believe that the lead auditor should either retain the information from the other auditor or complete its own documentation related to the significant transaction. We do not believe that it is necessary for the lead auditor to retain information related to related parties or relationships that are not previously disclosed. First of all, this does not provide a level of significance such as significant or material related party transactions. Second, we feel that it is appropriate for this information to be documented within the lead auditor or other auditor work papers, but it is not necessary to be in both locations.

Question 44:

In addition to the information currently in AS 1215.19g about all significant deficiencies and material weaknesses in internal control over financial reporting, should the office issuing the auditor's report be required to obtain, review, and retain information about all control deficiencies identified by other offices of the firm and other auditors?

Response:

As required by AS 2201 paragraph 62 "The auditor must evaluate the severity of each control deficiency that comes to his or her attention to determine whether the deficiencies, individually or in combination, are material weaknesses." Based on this requirement, we believe that all deficiencies should be communicated to the lead auditor. The lead auditor would not be able to evaluate all deficiencies to determine if the combination would lead to a material weakness if these deficiencies were not communicated. Therefore, we feel that the other auditor should provide documentation of all deficiencies to the lead auditor.

Question 46:

Are there any additional engagement quality review procedures that should be required for audits that involve "other auditors" or "referred-to auditors" (as proposed to be defined)?



Response:

We do not believe that any additional review procedures should be required for the engagement quality reviewer.

Question #47:

Are the objectives of the proposed new standard clear and appropriate? If not, what changes are necessary?

Response:

We suggest broadening the objectives. The proposed objectives are focused on two elements of this process: 1) Consolidation or combination of accounts and 2) Preparation of the lead auditor's report. We feel the objectives should also cover the assessment of the referred-to-auditor's independence and competence and proper communication between the lead auditor and referred-to-auditor to clarify roles and responsibilities.

The requirements and the introduction appear reasonable. Therefore, this response suggests improved alignment between the objectives with the rest of the proposed standard.

Question #48:

Are the proposed requirements for performing procedures with respect to the audit of the referred-to auditor clear and appropriate? If not, what changes are necessary?

Response:

The proposed requirements appear clear and appropriate.

Question #49:

Are the conditions included in paragraph .06 of the proposed new standard clear and appropriate? Are there other conditions that should be met for the lead auditor to divide responsibility with a referred-to auditor?

Response:

The conditions in paragraph .06 are clear and appropriate.

Question #50:

Paragraph .07 of the proposed new standard describes the lead auditor's course of action in situations in which the lead auditor cannot divide responsibility. Are the requirements in this paragraph clear and appropriate? Why or why not? Are additional requirements necessary for such situations?

Response:

The proposed requirements appear clear and appropriate.



Question #51:

An unintended consequence of the Board's proposal, described earlier in this release, is the potential increase in the use of the divided responsibility model by auditors. Should the Board prohibit divided responsibility arrangements or impose further limitations on them, such as limiting them to equity method investees or situations in which the referred-to auditor covers only a small portion of the consolidated assets or operations? If so, what would be the costs and benefits of such a prohibition or limitation?

Response:

It would be helpful for the Board to include its insight into appropriate circumstances for the proposed new standard's use. Such language was included in AS 1205 for engagements with divided responsibility. Limitation of its use is otherwise not deemed necessary.

While we understand the Board's concern that the lead auditor may prefer to divide responsibility with another firm rather than coordinate with and supervise overseas teams, we feel there are inherent practicalities which will already limit this model's use.

We believe firms are more likely to use affiliated firms within their global accounting firm networks to perform 'other auditor' work. GNFs and NAFs spend significant time and resources on common branding. Such "one firm" marketing is seen as an asset within the marketplace. Dividing responsibility between firms in the same network may adversely impact branding.

We acknowledge not all firms are party to such networks and may utilize unaffiliated firms in the performance of audits. However, as the Board noted within its release, U.S. and non-U.S. GNFs audited 56% of public companies trading on U.S. exchanges, which accounted for over 99 percent of global market capitalization. Therefore, we feel this viewpoint is representative of the majority of the profession.

Additionally, it's preferential to companies to engage one network with closely branded firms and one overarching system of quality control. As compared to engaging multiple unaffiliated firms, this arrangement eliminates redundancies in the audit process, thereby eliminating time demands of the companies' personnel by its auditors.

Lastly, lead auditors will be reluctant to appear unable to coordinate with other firms. Effective coordination and collaboration is seen as a value added component by companies given the delays and communication issues which can be common in such arrangements. Dividing responsibility may be seen as an inability to collaborate with other firms.

In summary, we feel the demands and expectations of companies will outweigh the lead auditors' desire to increase its use of the divided responsibility model.

Question 52:

Are additional requirements, including supervisory requirements, necessary to describe responsibilities of the lead auditor in situation in which the lead auditor divides responsibility for the audit with another accounting firm? Are there any other situations that would present challenges with the application of the proposed requirements?

Response:



We do not believe any supervisory requirements should be added to the proposed standard for the lead auditor related to the situation when the lead auditor divides responsibility for the audit with another accounting firm. This situation relates to when responsibility for the audit is divided. If the lead auditor has supervisory requirements, it would complicate the situation and potentially confuse the public since supervisory responsibilities would go beyond a division of responsibility. If the lead auditor supervised the other auditor that has responsibility for a portion of the audit, it could lead someone to determine that the lead auditor did not divide responsibility and may have responsibility over the entire audit. This is contrary to the division of responsibility included in the standard.

Question 53:

Is superseding AI 10 appropriate, or is the interpretation necessary to fully describe the auditor's responsibilities under PCAOB standards?

Response:

We believe that superseding AI 10 is appropriate and that the concepts in AI 10 are included in the proposed standard.

Question #54:

Are the other proposed amendments relating to inquiries about professional reputation and standing of other auditors appropriate and clear in the context of each requirement? If not, what further amendments should the Board consider making to this requirement to improve its clarity?

Response:

We recommend that the Board clarify its expectations of lead auditors when other auditors are deemed to have insufficient experience and knowledge. Is increased oversight sufficient, or does the Board expect the lead auditor to engage a different firm with a higher level of relevant experience and knowledge? Or should the lead auditor provide the necessary resources to complete the audit.

Question 57:

Paragraph .10d of AS 1301 (currently Auditing Standard No. 16), Communications with Audit Committees, describes requirements regarding the lead auditor's communication to the audit committee of certain information about the other auditors. Should the lead auditor's communication to the audit committee with respect to the lead auditor's or other auditors' responsibilities in an audit be more specific than is currently required? If so, what additional information should the lead auditor communicate?

Response:

We think what is required in 10d and e is sufficient. If you delve too deeply into specific high risk areas, etc., then you invite controversy over auditor judgments. Paragraph 10e already asks the lead auditor to state the basis for the lead partner's determination that their supervision of other firms was sufficient. We believe this information would be sufficient.

Question 58:

Because the Board's proposal focuses on audit engagements, it does not include amendments for engagements other than audits. Should the proposal include changes for reviews of interim financial information under AS 4105, Reviews



of Interim Financial Information (currently AU sec. 722, Interim Financial Information) that involve "other auditors" or "referred-to auditors" (as proposed to be defined)? If so, what additional changes are needed?

Response:

Yes, this should also cover interim reviews.

Question 59:

Is it sufficiently clear when AS 1201 (as proposed to be amended) or proposed AS 1206 – as opposed to AS 2503 – would apply to an audit of a company's equity method investment or other investments in an entity whose financial statements are audited by another accounting firm? If not, what change or guidance is needed?

Response:

We think it is clear. AS 1206- page A2-1, footnote 3, states the definition of financial statements that include- "through consolidation or combination- the financial statements of the company's business units." To add clarity, you could state the referred to auditor would not include the auditor of equity method investments or other investments whose financial statements are audited by another accounting firm.

The Illinois CPA Society appreciates the opportunity to express its opinion on this matter. We would be pleased to discuss our comments in greater detail if requested.

Sincerely,

James R. Javorcic, CPA

Chair, Audit and Assurance Services Committee

Scott Cosentine

Vice Chair, Audit and Assurance Services Committee



APPENDIX A

AUDIT AND ASSURANCE SERVICES COMMITTEE ORGANIZATION AND OPERATING PROCEDURES 2016 – 2017

The Audit and Assurance Services Committee of the Illinois CPA Society (Committee) is composed of the following technically qualified, experienced members. The Committee seeks representation from members within industry, education and public practice. These members have Committee service ranging from newly appointed to almost 20 years. The Committee is an appointed senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of audit and attestation standards. The Committee's comments reflect solely the views of the Committee, and do not purport to represent the views of their business affiliations.

The Committee usually operates by assigning Subcommittees of its members to study and discuss fully exposure documents proposing additions to or revisions of audit and attestation standards. The Subcommittee develops a proposed response that is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times includes a minority viewpoint. Current members of the Committee and their business affiliations are as follows:

Public Accounting Firms:

National:

Timothy Bellazzini, CPA	Sikich LLP
Todd Briggs, CPA	RSM LLP
Scott Cosentine, CPA	Ashland Partners & Company LLP
Heidi DeVette, CPA	Johnson Lambert LLP
Eileen M. Felson, CPA	PricewaterhouseCoopers LLP
Michael R. Hartley, CPA	Crowe Horwath LLP
James R. Javorcic, CPA	Mayer Hoffman McCann P.C.
Timothy Jipping, CPA	Plante & Moran PLLC
John Offenbacher, CPA	Ernst & Young LLP
Elizabeth J. Sloan, CPA	Grant Thornton LLP
Richard D. Spiegel, CPA	Wipfli LLP
Kevin V. Wydra, CPA	Crowe Horwath LLP

Regional:

Jennifer E. Deloy, CPA	Marcum LLP
Barbara F. Dennison, CPA	Selden Fox, Ltd.
Genevra D. Knight, CPA	Porte Brown LLC
Andrea L. Krueger, CPA	CDH, P.C.

Local:

Matthew D. Cekander, CPA	Doehring, Winders & Co. LLP
Lorena C. Johnson, CPA	CJBS LLC
Mary Laidman, CPA	DiGiovine, Hnilo, Jordan & Johnson, Ltd.
Carmen F. Mugnolo, CPA	Trimarco Radencich, LLC
Jodi Seelye, CPA	Mueller & Company LLP
Joseph Skibinski, CPA	

Industry:

Matthew King, CPA	Baxter International Inc.
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Educators:

David H. Sinason, CPA

Northern Illinois University

Staff Representative:

Heather Lindquist, CPA

Illinois CPA Society



November 15, 2017

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 PCAOB
 1666 K Street, NW
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 USA

submitted via email to comments@pcaobus.org

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**PCAOB Release No. 2017-005, September 26, 2017,
 PCAOB Rulemaking Docket Matter No. 042: Supplemental Request for
 Comment: Proposed Amendments Relating to the Supervision of Audits
 Involving Other Auditors and Proposed Auditing Standards – Dividing
 Responsibility for the Audit with Another Accounting Firm**

Dear Sirs,

The IDW appreciates the opportunity to comment on the above mentioned Release, hereinafter referred to as “the 2017 Release”. We also commented on the 2016 Release under Rulemaking Docket No. 042 in a letter dated July 29, 2016. In commenting below on specific aspects of the current proposal we refer to that letter as “our previous letter”.

In this letter, we express general support for the PCAOB’s initiative, and then comment on those aspects of the Release with which we have specific concerns. Since divided responsibility is not prevalent in Germany, we have again chosen not to comment on the aspects of the Release relating to division of responsibility. Furthermore, we have chosen not to respond to individual questions posed throughout the Release.

General Support

As stated in our previous letter, we agree that the revision of the PCAOB’s interim auditing standards is needed in this area. We also support many of the changes proposed in order to address matters raised within comments received on the 2016 Proposal.

GESCHÄFTSFÜHRENDER VORSTAND:
 Prof. Dr. Klaus-Peter Naumann,
 WP StB, Sprecher des Vorstands;
 Dr. Klaus-Peter Feld, WP StB;
 Dr. Daniela Kelm, RA LL.M.



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Soliciting Awareness of all Firms Likely to be Impacted by the Proposals

We note that, in addition to discussions held in the SAG in 2016 and 2017, the PCAOB received only 23 comment letters on its 2016 Release.

The issue of supervision of other auditors involved in an audit pursuant to PCAOB Auditing Standards is significant to many foreign audit firms – not just those who are required to be registered with the PCAOB themselves, since such firms often undertake audit work in the role of other auditor. Indeed in requiring the lead auditor to obtain certain documentation and an understanding of certain internal processes and policies and procedures, the proposed changes would, indirectly, impose certain new requirements directly on such firms.

We suspect that many non-registered firms are less aware of the detailed content of the Board's Releases than might be expected of registered firms, although many of them are, or may be, indirectly affected by the PCAOB's supervision standards.

We would encourage the Board to take steps to obtain greater involvement in its debates going forward and to raise awareness of the impact on firms serving in the role of other auditor. In this context, we also believe that alignment as far as possible to the ISAs is desirable in terms of promotion of audit quality and refer to our comments below in this regard.

Extending the Role of Lead Auditors

In our previous letter we expressed concern that the 2016 proposals would result in lead auditors having to adopt a highly bureaucratic approach to the supervision of other auditors. In general, we retain this concern.

A new aspect of the revised proposals would require the lead auditor who uses the work of an "other auditor" to obtain understanding of each of the other auditors' internal processes for determining compliance in terms of independence (AS 2101 .B4 a.) and to inquire about the other auditors' policies and procedures in regard to training of technical expertise (AS 2101 .B6 a.(2)). The standard does not indicate criteria by which a lead auditor can determine whether a particular process, policy or procedure is appropriate for individual audit circumstances. Our concern is that this particular requirement could result in inconsistent or even unrealistic expectations as to processes, policies and procedures that other firms should have in place, and thus could de-facto imply further requirements for other auditor firms.



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Documentation

The explanation on page 20 of the 2017 Release implies the other auditor may need to document beyond the requirements of PCAOB standards. To the extent that this to be understood to refer to a “summary memorandum”, we believe that as far as foreign audit firms may be concerned, the proposed changes are more feasible than the 2016 Proposal. A memorandum prepared for the lead auditor (in some cases, the other auditor’s audit client would have to have given explicit consent (waiver of confidentiality)) supported by reference to the other auditor’s audit working papers and files etc. would appear to us to ensure the lead auditor is able to support the audit opinion and at the same time ensure that a foreign-based other auditor can adhere to e.g., confidentiality requirements of that auditor’s third country, where appropriate. German public auditors remain subject to restrictions on their ability to provide working papers (and access – as proposed to be required by AS 2101 B6c.) to third parties, including lead auditors.

Determination of Ability to Serve as Lead Auditor

We agree that the determination of the ability to serve as lead auditor is one of professional judgement, and support the addition of “importance of the location or business unit audited by the lead auditor” as a second factor to take into account in this determination. However, without explicit guidance, the term “importance” could be subject to misapplication – i.e., importance is measured by reference to head office decision making, whereas it may be difficult to really “prove” where the decisions are really made. The IAASB has been considering the issue of so-called letter box audit issue in some jurisdictions in this context, and their deliberations in this regard may be useful to the PCAOB. Although the proposed addition of a benchmark for the engagement partner’s firm (ordinarily 50% of assets or revenues) may be helpful guidance, it potentially may mean that some groups might become un-auditable without division of responsibilities.

Calls for Clarification

Many of the comments discussed in the 2017 Release are actually calls for clarification. We have previously commented on the lack of application guidance within PCAOB Auditing Standards and guidance about how the requirements in these standards could be adhered to in practice. We suspect this issue is particularly difficult for firms that perform few audits according to PCAOB Auditing Standards (primarily smaller or foreign firms and especially any of



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these who are “other auditors”). Without additional guidance such auditors may only find out the true desires of the PCAOB when its inspection teams report a finding, which is arguably not a useful way to achieve audit quality in a timely manner. The revised proposals in the 2017 Release go some way to addressing comments received (see also page 42 of the 2017 Release, where the Board explains the economic impact) and many of the additional explanations now given only within the Release are certainly helpful in this regard. However, in addition to explaining the Board’s views in the 2017 Release, it would be equally appropriately to add these clarifications (including the use of notes etc.) within the body of the standards.

We support the clarification on page 40 of the 2017 Release. However, the fact that commenters raised concerns as to the practical implementation of scalability (ref: page 40 of the 2017 Release) indicates the need for better clarification in this regard. We consistently hear that auditors’ uncertainty as to what regulators expect results in the performance of excessive work in some areas (i.e., costly inefficiencies) that could perhaps be reigned-in if more clarification were provided. To illustrate with just one example: clarification of the reference to “important audit tasks” (bottom of page 15 of the 2017 Release) would be helpful in understanding the practical application of AS 2101 .B6.

We further note the proposed introduction of a requirement for the other auditor to provide a written description of all relationships “reasonably thought to bear upon independence” (AS 2101 .B4 b.(1)). This documentation shall inform the lead auditor’s determination of compliance with SEC and PCAOB independence requirements by enabling the lead auditor to perform procedures to determine the effect of any inconsistent information arising during the course of the audit, of which the lead auditor becomes aware. In order to prepare such documentation and for the intended purpose to work effectively, the other auditor would need to have a clear understanding of the term “reasonably thought to bear upon independence”. Specific guidance in the standard would thus be useful in this context. Indeed, clarification of the lead auditor’s role in ensuring that the other auditor properly understands the requirements pertaining to the audit might also be appropriate.

Desirability of Alignment with the International Standards on Auditing (ISA)

We refer to our previous letter in which we also referred to the desirability of aligning PCAOB standards with their corresponding ISA to the maximum extent possible. We note that there is little reference in the 2017 Release to calls for, or



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the desirability of, alignment with ISAs, which is disappointing, since given the level of involvement of other auditors, ensuring compliance is as straightforward as possible for audit firms with relatively little involvement in audits pursuant to PCAOB standards would also be a factor in increasing audit quality.

We would like to reiterate our calls for maximum possible alignment and urge the two respective Boards to coordinate in this regard.

If you have any questions relating to our comments in this letter, we should be pleased to discuss matters further with you.

Yours truly,

Klaus-Peter Feld
Executive Director

Gillian Waldbauer
Head of International Affairs



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November 15, 2017

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

PCAOB Rulemaking Docket Matter No. 042: 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

Dear Ms. Secretary:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or the Board) Release No. 2017-005, *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* (referred to as the proposed amendments and the proposed standard, respectively, and collectively as the Supplemental Request for Comment).

The Board has requested public comment on the Supplemental Request for Comment that is intended to improve audit quality and investor protection through enhancements to the current requirements related to the lead auditor's responsibilities concerning 1) the supervision of other auditors and 2) referred-to auditors. We continue to support the Board's initiative to further strengthen audit quality and investor protection with respect to audits that involve other auditors and referred-to auditors.

Overview

KPMG appreciates the PCAOB's efforts to acknowledge and respond to the comments it received in relation to Release No. 2016-002, *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Accounting Firm* (the 2016 Proposal), through its Supplemental Request for Comment. We continue to support the Board's goal to provide a more uniform, risk-based approach to supervision in audits that involve other auditors and agree further considerations and amendments to Auditing Standard (AS) 2101, *Audit Planning*, and AS 1201, *Supervision of the Audit Engagement*, are necessary to achieve this goal.

The Supplemental Request for Comment clarified certain items in the 2016 Proposal about which we had concerns, particularly with respect to the criteria for sufficiency of participation as the lead auditor and the other auditor's responsibility to perform work with due professional care. However, we offer the following comments on the proposed amendments and proposed standard where further clarification and guidance may be warranted, as well as observations regarding anticipated challenges and costs relative to anticipated benefits.

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Definitions

We note that the release text in the Supplemental Request for Comment indicates that “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.”¹ We recommend that the Board include this concept in the final amendments and final standard as part of the definition of lead auditor. We believe this information is essential to facilitate consistent interpretation and application of this term from the onset of its introduction by the proposed amendments and proposed standard.

Similarly, we recommend that the release text noted below from footnote 20 of the Supplemental Request for Comment be explicitly incorporated into paragraph .B4 of AS 2101:

The definition of "other auditor" includes both a firm and individuals from that firm. As a practical matter, this requirement would typically be applied at the firm level because the other auditor firm would typically have both the processes for determining compliance with PCAOB independence and ethics requirements and SEC independence requirements and some level of experience in applying those requirements. This requirement would be applied at the individual level for participating persons who are not part of a firm.

This addition would provide clarity regarding the level at which the lead auditor applies the requirement and would reduce the likelihood of misinterpretation (specifically, for example, by misapplication of the requirement at the individual level when the participant is a member of a firm). Misinterpretation of this nature could result in the lead auditor performing procedures beyond the intended scope of the proposed amendments, which would result in increased costs and may harm audit quality as a result of incorrectly focused efforts. We have additional observations concerning paragraph .B4 of AS 2101, which are noted below in the “Other auditor’s compliance with independence and ethics requirements” section of this letter.

Determination to serve as lead auditor

We believe the sufficiency of participation in the audit by the lead auditor should be a risk-based assessment with collective consideration of quantitative and qualitative factors. Accordingly, we agree with the proposed revision to paragraph .B2b of AS 2101 that enables the lead auditor to consider qualitative criteria, such as the importance of the locations or business units for which the lead auditor performs procedures, in the determination of sufficiency of participation.

¹ Supplemental Request for Comment, page 34.

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However, we do not believe the addition of the following sentence to the end of paragraph .B2 of AS 2101 is needed:

“In addition, the participation of the engagement partner’s firm to serve as lead auditor ordinarily is not sufficient if the referred-to auditors, in aggregate, audit more than 50 percent of the company’s assets or revenues.”

As noted by the Board, the Financial Reporting Manual of the SEC’s Division of Corporation Finance already provides similar guidance, and therefore we believe including the above threshold in the final amendments would be repetitive and is unnecessary.

Other auditor’s compliance with independence and ethics requirements

We believe that requiring the lead auditor to gain an understanding of the other auditor’s process for determining compliance with SEC independence requirements and PCAOB independence and ethics requirements and their experience in applying those requirements presents several challenges and other implications that should be considered by the Board in the final amendments. Such challenges and implications include the following:

- *Capabilities of lead auditor engagement team* – We are concerned that the requirement to obtain an understanding of the other auditor’s process for and experience with determining compliance with independence and ethics requirements appears, from the release language, to include the responsibility to identify gaps that may exist in the other auditor’s process and evaluate the impact of those gaps on the audit. This would greatly expand the lead auditor engagement team’s procedures in this area and may require the specialization and expertise of others outside of the team, such as those experienced in the evaluation of firm-level processes and controls over SEC independence requirements and PCAOB independence and ethics requirements. Therefore, we are concerned that the lead auditor engagement partner may not have the ability or necessary knowledge to determine the sufficiency of or identify issues in the other auditor’s compliance process to the extent described in the proposed amendments.
- *Scalability of procedures* – As proposed, the extent of procedures required to determine compliance with the SEC independence requirements and the PCAOB independence and ethics requirements is the same across all other auditors regardless of whether or not the other auditor is a (i) PCAOB registered accounting firm, or (ii) member firm of the lead auditor accounting firm. Network member firms typically implement systems of quality control to comply with local professional standards and incremental procedures that are required as a condition of being a member firm of the network. In addition, PCAOB registered accounting firms are required to comply with the PCAOB’s quality control standards. The other auditor’s adoption of these commonly understood requirements for systems of quality control should be a factor the lead auditor may consider when assessing the extent of procedures required to determine the other auditor’s compliance with the independence and ethics requirements.

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- *Increased costs* – This aspect of the proposed amendments would result in a significant increase in costs for audit firms and therefore issuers due to: (i) the lead auditor performing additional procedures, beyond those required by the current auditing standards, to gain an understanding of each other auditor’s process and to determine their compliance with the SEC independence requirements and PCAOB independence and ethics requirements to the extent proposed; and (ii) duplication of procedures over the same other auditor across multiple engagements (e.g., an engagement team from Firm A that serves as lead auditor for Entity X would need to determine compliance by Other Auditor 1 with the SEC independence requirements and the PCAOB independence and ethics requirements, and a separate engagement team from Firm A that serves as lead auditor for Entity Y would also need to perform those same procedures if Other Auditor 1 participated in that audit). The corresponding benefit from an audit quality perspective of these increased costs to investors and registrants is unclear.

As expressed in our previous comment letter², we believe that the proposed amendments should allow the lead auditor to rely on the other auditor’s system of quality control in certain situations. Instead, the proposed amendments require the lead auditor to gain an understanding of the other auditor’s process to determine its compliance with SEC independence requirements and PCAOB independence and ethics requirements. PCAOB registered accounting firms are required to establish and apply a quality control system comprised of elements focused on, but not limited to, independence, objectivity, and the acceptance and continuance of clients and engagements. In addition, we believe that network member firms typically establish a system of quality control that complies with a globally recognized set of quality control standards. For example, KPMG member firms are required to comply with International Standard on Quality Control 1, *Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements* (ISQC 1), and to implement quality controls that fulfill provisions of Rule 2.01(d)(4) of Regulation S-X. We believe that the representation of a PCAOB registered accounting firm that their system of quality control is in compliance with the PCAOB quality control standards or a globally recognized set of quality control standards used by the network member firm that is comparable to the PCAOB’s quality control standards should be sufficient for purposes of the lead auditor’s assessment of the other auditor’s compliance with SEC independence requirements and PCAOB independence and ethics requirements.

Therefore, we recommend the Board revise the proposed requirement at paragraph .B4b of AS 2101 to allow the receipt of such written representation to be independently sufficient in instances where the other auditor is a PCAOB registered accounting firm or a network member firm with a system of quality control based on a globally recognized set of quality control standards. If information comes to the attention of the lead auditor that the written representation is false, inaccurate, or otherwise cannot be relied upon, we agree that the lead auditor should perform additional procedures to determine the effect of such information on the independence of the

² [KPMG comment letter on PCAOB Rulemaking Docket Matter No. 042](#), July 29, 2016.

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other auditor. Similarly, in those situations where the other auditor is not a PCAOB registered accounting firm nor a network member firm of the lead auditor (and therefore subject to standardized requirements for its system of quality control), we agree that procedures designed to allow the lead auditor to gain an understanding of the other auditor's process for determining compliance with the SEC independence requirements and PCAOB independence and ethics requirements should be required.

In addition, the requirement in paragraph .B4b.(2) of AS 2101 could be interpreted to be overly broad in that it can be read to imply that any violation of the SEC independence requirements or PCAOB independence and ethics requirements (e.g., a violation that relates to another audit client) would necessitate the other auditor to represent that it is not in compliance, and to provide a description of the nature of the non-compliance. Such a requirement would likely result in issues with respect to the disclosure of client confidential information. We believe the representation as to compliance, and the description of the nature of any non-compliance, should focus solely on the specific audit client for which the accounting firm is serving as an other auditor.

Other auditor's knowledge, skill, and ability

Although we agree with the Board that the lead auditor should determine the necessary extent of supervision of the other auditors, we do not support the proposed revisions in paragraph .B6a of AS 2101 requiring the lead auditor to inquire of the other auditor's policies and procedures related to the assignment and training of individuals who work on audits conducted under PCAOB standards. The lead auditor engagement team may not be qualified to sufficiently evaluate another firm's work assignment procedures or training curriculum. An engagement partner will typically rely on his/her own firm's system of quality control with respect to the engagement team's knowledge, skill, and ability, particularly the policies and procedures over assignment and training of individuals. Furthermore, the lead auditor gains more valuable and representative information regarding the other auditor's knowledge, skill, and ability through the interactions and prior experience with the other auditor, rather than through inquiring about the other auditor firm's policies and procedures over work assignments and training curriculum. Therefore, such an inquiry and response concerning the other auditor's assignment and training policies and procedures would unlikely provide a meaningful basis for the lead auditor to conclude on the other auditor's knowledge, skill, and ability. The requirement to make inquiries of the other auditor about its policies and procedures for 1) the assignment of individuals to audits conducted under PCAOB standards and 2) training curriculum for individuals who perform procedures on audits conducted under PCAOB standards, as proposed, would result in increased costs, and the benefit to audit quality and investor protection is not clear.

Further, similar to the above requirement to determine the other auditor's compliance with independence and ethics requirements, consideration of a firm's system of quality control, whether established in accordance with PCAOB quality control standards or a globally recognized set of quality control standards such as ISQC 1, should be an element in this

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assessment of the other auditor. An accounting firm's system of quality control incorporates elements relating to personnel management, engagement management, and monitoring. We recommend the Board incorporate reliance on a firm's system of quality control to complement the proposed amendments with pre-existing quality control standards. We also recommend the Board consider revising the proposed requirement in paragraph .B6a of AS 2101 to require that the lead auditor obtain a written representation from the other auditor stating compliance with the personnel management aspects (i.e., work assignments and training curriculum) of the PCAOB's quality control standards.

Regardless of whether the Board decides to allow reliance on a PCAOB registered accounting firm's or a network member firm's system of quality control, we believe the Board should establish the minimum requirements that should be met to demonstrate the other auditor's knowledge, skill, and ability as intended by the Board's proposed amendments.

AS 1206

Although the Board clarified that procedures to evaluate the referred-to auditor's qualifications were limited to inquiry and other information obtained during the course of the audit³, the proposed standard uses language that the "lead auditor determines ... that the referred-to auditor knows the relevant requirements of the applicable financial reporting framework, standards of the PCAOB, and financial reporting requirements of the SEC"⁴, which appears to be the same objective in paragraph .B6b.(2) of AS 2101. This could be interpreted to mean that procedures beyond inquiry might be required for the lead auditor to make a reasonable assessment of the referred-to auditor's qualifications, which we do not believe is necessary given the division of responsibility. Because we do not believe the Board intended for the extent of procedures to be consistent for other auditors and referred-to auditors, we request the Board add a note to the final standard that would explicitly indicate that there is a distinction in the procedures to be performed by the lead auditor to determine the sufficiency of the other auditor's and referred-to auditor's qualifications.

Effective Date

Substantial changes to our audit methodology will be required to effectively implement the final amendments and final standard, if they are representative of what is reflected in the Supplemental Request for Comment. It will be necessary to issue policies and procedures and to train our audit professionals, including those throughout our network member firms who participate in audits conducted under PCAOB standards. Further, planning and coordination of the audit by the lead auditor with the other auditors typically occurs early in the audit planning phase (e.g., March for December fiscal year-end engagements) and sufficient time will be necessary for lead auditor engagement teams to successfully incorporate the new requirements into their audit plan. Therefore, we recommend that the effective date of the final amendments and final standard be

³ Supplemental Request for Comment, page 26.

⁴ Proposed AS 1206.06b, Supplemental Request for Comment, page A3-3.

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for audits of fiscal years beginning two years after the year of the SEC's approval of the final amendments and final standard.

* * * * *

We appreciate the Board's careful consideration of our comments and observations, and support the Board's efforts to increase accountability of the lead auditor and improve audit quality and investor protection. If you have any questions regarding our comments included in this letter, please do not hesitate to contact Matt Doyle ((212) 954-2187) or mrdoyle@kpmg.com) or Rob Chevalier ((212) 909-5067 or rchevalier@kpmg.com).

Very truly yours,



KPMG LLP

cc:

PCAOB

James R. Doty, Chairman
Lewis H. Ferguson, Member
Jeanette M. Franzel, Member
Steven B. Harris, Member
Martin F. Baumann, Chief Auditor and Director of Professional Standards
Keith Wilson, Deputy Chief Auditor

SEC

Jay Clayton, Chairman
Michael S. Piwowar, Commissioner
Kara M. Stein, Commissioner
Wesley R. Bricker, Chief Accountant
Julie A. Erhardt, Deputy Chief Accountant
Jenifer Minke-Girard, Interim Deputy Chief Accountant
Marc A. Panucci, Deputy Chief Accountant
Sagar S. Teotia, Deputy Chief Accountant



November 15, 2017

By email: comments@pccaobus.org

Hunter College Graduate Program
Economics Department
695 Park Ave.
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Re: PCAOB 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, September 26, 2017) (PCAOB Rulemaking Docket Matter No. 042)

To Whom It May Concern:

The Advanced Auditing class (ACC 775) at Hunter College Graduate program in New York City appreciates the opportunity to comment on this exposure draft.

The class discussed the above proposed exposure draft and have attached our comments. If you would like additional discussion with us, contact Professor Joseph A. Maffia, at 917-847-6382.

Sincerely,

A handwritten signature in black ink that reads "Joseph A. Maffia". The signature is written in a cursive, slightly slanted style.

Professor Joseph A. Maffia, CPA

**Hunter College Graduate Program
Economics Department
Advanced Auditing Class
ACC 775**

**COMMENTS TO THE Public Company Accounting Oversight Board
ON THE proposed Exposure Draft PCAOB Release No. 2017-005 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**

November 15, 2017

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**Hunter College Graduate Program
Economics Department
Advanced Auditing Class
ACC 775**

**Comments To The Public Company Accounting Oversight Board
On The proposed Exposure Draft PCAOB Release No. 2017-005 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**

GENERAL COMMENTS

The Advanced Auditing Class has reviewed the above-referenced PCAOB Exposure Draft for supplemental request for comment and offers the following comments for consideration by the Public Company Accounting Oversight Board. In general, we agree with the proposed changes; however, we've identified areas that can be further enhanced. The areas can be categorized as comments pertaining to specific questions.

COMMENTS PERTAINING TO SPECIFIC QUESTIONS

Question 1 (page A1-3):

The revised requirement for determining the sufficiency of participation to serve as lead auditor, based on risk and importance of the locations is not clear. The first requirement that the lead auditor must consider being sufficient in regards to risk of material misstatement associated with the lead auditor in comparison with the portion of other auditors or portions audited by the referred-to auditors should also explicitly state whether the comparison should be applied singly or aggregately. We recommend the first requirement of paragraph .B2a to be modified as follows:

“The risk 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 **singly, not in the aggregate;** and”

Also, as mentioned in Section III.A.1 of this release, commenters had suggested additional criteria to be considered for determining sufficiency of participation. In response, the proposed changes give a heavier weight on risk of material misstatement and extend the requirement of including the assessment of the locations or business units as an additional consideration. The qualitative factor should be elaborated further to suggest additional guidance on what qualitative

factors should take precedence in situations for determining sufficiency of participation for audits that are complex, for example, locations and business units of parent-subsidary consolidations.

In addition, we recommend paragraph B2b to be modified as follows:

“The importance of the locations and business units for which the engagement partner’s firm perform audit procedures in relation to the financial statements of the company as a whole taking into account quantitative factors **that could be generic empirical information such as physical metrics, or monetary values such as financial metrics and qualitative factors such as reputation, enterprise specific cases of compliance and business ethics and also operating environment factors such as market and regulations, economic trends, political realities and social license to operate.**”

Question 2 (page A1-3):

The proposed requirement would require that the engagement partner determine its sufficiency of participation based on the risk of material misstatement associated with the portions of materiality of the financial statements, audited by the lead auditor in comparison with portions of the other auditors. The question is, does combining a risk approach with a bright line better than the previous principle-based methodology? For example, what if the lead auditor is auditing the riskier parent company, but does not meet the 50% requirement?

Consideration of the 50% threshold should also be given to multi-tiered audits where the other auditor, who is not the lead auditor, audits the Financial Statements of a location or business unit and its subsidiaries that has international locations. If the work done by the other auditor exceeds the 50% threshold for assets or revenues, the lead auditor should still be allowed to serve as lead auditor once the requirements of AS1201 are met. As long as the lead auditor receives adequate information about the communications, the lead auditor can still take charge of the engagement even though the 50% threshold requirement has not been met. Just as in the case of AS1201, the lead auditor should be required to submit an argument for not meeting the 50% threshold in writing.

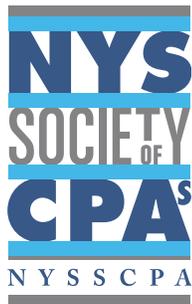
The additional qualitative threshold for divided responsibility engagements is not clear merely because it does not take into account other situations that may arise. We must consider how this would be interpreted in the case where there are several auditors, and no sole auditor audits more than 50% of the assets. For example, in the situation where there are four auditors that audit 25% each, there is no sole auditor that audits more than 50% of the assets. If there are four auditors that audit 20%, 20% 30% and 30%, no sole auditor audits more than 50% and two auditors audit the majority. For further clarity, this bright-line requirement should include when there are three or more auditors but no sole auditor audits the majority the responsibility should be proportional. However, if two auditors audit the majority further application guidance is needed.

Also, please explain how the 50% of the company's assets or revenues threshold is evaluated. In the instance, that one auditor audits 50% of the company's assets, and another auditor audits 50% of the revenues it should be stated which takes precedence. A possible solution might be to consider the greater of revenues or assets. In addition, factors such as industry background and type of company can be taken into account when determining which is a preferable benchmark to use. We must also consider risk of material misstatement when determining the 50% threshold. For example, in cases where assets may not meet the 50% threshold but there is a higher risk of material misstatement, the lead audit may not meet the 50% threshold but plays a more influential role in the overall quality of the audit.

Question 5 (A1-8; B2 paragraph b):

The proposed revision to AS 1201 relating to the other auditor's responsibility does not provide sufficient guidance for the lead auditor. Please provide further clarification on the extent to which the lead auditor must supervise the other auditors in the engagement. If each lead auditor is to determine the extent of supervision over other auditors, there should be a guideline to follow in order to know how much supervision is needed. A possible solution would be assessing the other auditors based on categories such as years of experience, industry experience, or familiarity with the client. This would help the lead auditors have a more clear guideline to follow when decided how much supervision is needed for each "other auditor."

We respectfully submit these comments with the hopes that the final decision of the PCAOB is in the best interest of the profession as a whole. Should you desire further explanations, please do not hesitate to contact us.



November 13, 2017

Office of the Secretary
PCAOB
1666 K Street, NW
Washington, D.C. 20006-2803

By e-mail: comments@pcaobus.org

Re: Supplemental Request for Comment – Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Accounting Firm

(Release No. 2017-005; PCAOB Rule Making Docket Matter No. 042)

Dear Mr. Secretary:

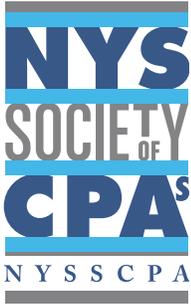
The New York State Society of Certified Public Accountants (NYSSCPA), representing more than 26,000 CPAs in public practice, business, government and education, welcomes the opportunity to comment on the above-captioned release.

The NYSSCPA's SEC and Auditing Standards Committees deliberated the proposed standard and prepared the attached comments. If you would like additional discussion with us, please contact Joseph J. Puglisi, Chair of the SEC Committee, at (347) 505-6304, or Ernest J. Markezin, NYSSCPA staff, at (212) 719-8303.

Sincerely,

Harold L. Deiters III
President

Attachment



**NEW YORK STATE SOCIETY OF
CERTIFIED PUBLIC ACCOUNTANTS**

COMMENTS ON

**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**

(Release No. 2017-005; PCAOB Rulemaking Docket Matter No. 042)

November 13, 2017

Principal Drafters

From the SEC Committee:

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**Howard B. Levy
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New York State Society of Certified Public Accountants

Comments on

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*

(Release No. 2017-005; PCAOB Rulemaking Docket Matter No. 042)

General Comments

The New York State Society of Certified Public Accountants (NYSSCPA) appreciates the opportunity to comment on the Public Company Accounting Oversight Board’s (PCAOB or the Board) Release No. 2017-005, **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*** (Proposed Amendments).

We support the PCAOB’s efforts to strengthen the requirements for the lead auditor in the work of other auditors. The determination of whether the auditor’s participation is sufficient to enable him/her to serve as the lead auditor is a matter of professional judgment and should not be a bright-line requirement as each audit presents unique challenges and characteristics. We also find that much of the language contained in the Proposed Amendments is prescriptive in nature and may negatively impact the auditor’s ability to exercise of professional judgment.

Responses to Specific Questions from the Proposed Amendments

Presented below are our responses to selected questions from the Proposed Amendments.

Question 1: Is the revised requirement for determining the sufficiency of participation to serve as lead auditor, based on risk and importance of the locations, appropriate and clear?

Response: Yes, we believe that the proposed revised requirement is appropriate and clear.

Question 2: Is the additional sufficiency threshold for divided responsibility engagements clear? Should this be a bright-line requirement, or does this threshold need to allow for exceptional situations? Are there any other implications of this threshold that the Board should consider, such as investor protection implications or auditing challenges related to the revised requirement?

Response: Yes, we believe that the additional sufficiency threshold for divided responsibility is clear. We do not believe there should be a bright-line requirement because there might be certain

exceptional situations (however improbable) that might require professional judgment on the part of the auditor(s). We believe that the sufficiency threshold is consistent with prior practice and should not cause significant auditing challenges to implement.

Question 3: Are the revised requirements relating to the other auditors' compliance with the independence and ethics requirements appropriate? Are there any practical challenges associated with the revised amendments? If so, what are they, and how could the proposed requirements be revised to address the challenges?

Response: Gaining an understanding of the other auditors' process for determining compliance with SEC and PCAOB independence and ethics requirements is a significant improvement over requiring the lead auditor to assess the other auditors' knowledge of such requirements. We suggest that the understanding of the other auditors' process be limited to general observations and not require extensive detail. We also suggest that the requirement to gain an understanding of the other auditors' experience in applying the requirements is unnecessary and should be removed.

A written description of all relationships between the other auditor and the client or persons in financial reporting oversight roles that could appear to call into question the auditors' independence should only be required when the lead auditor determines that it is required, after he/she inquires about any such relationships.

A written representation about compliance or non-compliance with SEC independence and PCAOB independence and ethics requirements, and a description of any non-compliance is appropriate.

We agree that where the lead auditor becomes aware of contradictory information, the lead auditor should perform additional procedures to determine the effect of such information.

Question 4: Are the proposed amendments relating to the knowledge, skill, and ability of the other auditor, revised by this release, appropriate? Are there any practical challenges associated with the revised amendments? If so, what are they, and how could the proposed requirements be modified to address the challenges?

Response: No. We believe that the proposed amendments are not appropriate. Requiring inquiries about assignments and training of individuals, and then requiring consideration of responses to these inquiries would not be of added benefit to the audit and would be unnecessarily time consuming. The exercise would be redundant as any useful information about assignments and training can be found in peer review, internal inspection reports and similar documents.

Question 5: Are the proposed new addition to AS 1015 and revision to AS 1201 relating to other auditors' responsibilities appropriate and clear? Is it clear that AS 1015 already applies to referred-to auditors that perform audits under PCAOB standards?

Response: Providing the statement in AS 1015 that the work of other auditors are responsible for performing their work with due professional care is appropriate and clear.

Informing the other auditor of the necessary level of detail of the other auditors' description of audit procedures to be performed seems too granular. The lead auditor is responsible for supervising and reviewing the other auditors work so the inclusion of this statement does not add value.

Question 6: Are the proposed new additions to AS 2101.B2 appropriate and clear? Also, is it clear that the necessary level of detail of the other auditor's audit documentation that the lead auditor obtains and the necessary extent of the lead auditor's review according to requirements in proposed Appendix B of AS 1201 are scalable based on the factors in the existing standard regarding the necessary extent of supervision?

Response: Yes, the proposed new additions are clear and appropriate. We believe that scalability would be adversely affected by the prescriptive language found in the proposed amendments, which has the effect of restricting the auditor's exercise of professional judgment.

Question 7: Are the revised proposed requirements for situations in which the lead auditor directs another auditor to perform supervisory procedures with respect to a second other auditor on behalf of the lead auditor clear? If not, how should the revised proposed requirements be revised?

Response: We find that the revised proposed requirements for which the lead auditor directs the activities of other auditors whether that is done directly through the lead auditor or performed by another auditor on behalf of the lead auditor to be clear.

Question 8: Is the revision to the proposed standard relating to the division of responsibility when the company and its business unit use different reporting frameworks appropriate and clear?

Response: We find the revision to the proposed standard relating to the division of responsibility when the company and its business unit use different reporting frameworks to be clear.

Question 9: Is it clear how the proposed amendments and new standard (as revised by this release) relate to other amendments to auditing standards proposed or adopted by the Board since the 2016 Proposal.

Response: The proposed amendment does not address the lead auditor's responsibility for critical or key audit matters (CAMs or KAMs) reported by other auditors under the Auditor's Reporting Model, adopted June 2017. In addition, further clarification is needed to address the lead auditor's responsibilities for the use of specialist and internal auditors by other auditors not addressed in CAMs (or KAMs).

Question 10: Comment is requested on the matters discussed in this section. Would any revisions the Board is considering for adoption affect the scalability of PCAOB standards in this

area? Would any have a significant effect on the competitiveness of smaller audit firms? Would the revisions significantly change the costs and benefits associated with the proposed changes discussed in the 2016 Proposal? Are there any unintended consequences that the Board should consider? Are there any other matters not addressed in this release the Board should consider in its economic analysis?

Response: We do not see any issues with regard to scalability other than as set forth above in our response to Question 6. We have no comment regarding effects on the competitiveness of smaller audit firms – we believe it still remains to be seen. We do not believe that the revisions in the Proposed Amendment will significantly change the costs and benefits of the 2016 Proposal.

P B T K

**PIERCY BOWLER
TAYLOR & KERN**

Certified Public Accountants
Business Advisors

November 15, 2017

To: Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W., Washington, D.C. 20006-2803
Transmitted by e-mail to: comments@pcaobus.org

Re: PCAOB Rulemaking Docket Matter No. 042, Release No. 2017-005, Supplemental Request for Comment: *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard—Dividing Responsibility for the Audit with Another Accounting Firm*

We appreciate the opportunity to respond to the Board's Supplemental Request for Comment: entitled *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard—Dividing Responsibility for the Audit with Another Accounting Firm* that is contained in Release No. 2017-005 dated September 26, 2017 (the 2017 Release), of the Public Company Accounting Oversight Board (the PCAOB or the Board).

Because we have not previously commented in response to the related predecessor Release No. 2016-002, dated April 12, 2016 (the 2016 Release), we are availing ourselves of the opportunity offered by the Board to comment now on certain aspects of the original proposal. However, since the limited comment period designated in the 2017 Release is so short, this letter is necessarily briefer and less specific than it might otherwise have been.

Our comments are presented below in three parts. Part 1 of the attachment contains our general overriding concerns and reservations, and our direct responses to the ten questions¹ set forth in the 2017 Release by the Board are presented in Part 2. Part 3 contains certain editorial recommendations.

We hope the Board finds our comments useful as it continues its deliberations on this proposal. Please contact the undersigned at hlevy@pbtk.com or 702/384-1120 if there are any questions about these comments.

Very truly yours,

Piercy Bowler Taylor & Kern, Certified Public Accountants



Howard B. Levy, Principal and Director, Technical Services

Attachment

¹ We have provided responses only to those questions where we believed we could provide significant input to the Board.

Part 1 — Overriding Concerns and Reservations

We support the Board’s overall objectives as set forth in the 2016 Release including to:

- increase the involvement of the lead auditor in the work of other auditors;
- enhance the ability of the lead auditor to prevent or detect deficiencies in the work of other auditors and facilitate improvements in the quality of the work of other auditors; and
- strengthen existing requirements and impose a more uniform approach to the lead auditor's supervision of other auditors when assuming responsibility for their work.

Despite declarations throughout the 2017 Release² that proposed amendments to AS 1201 are “principles-based” and encourage a “scalable risk-based approach to the supervision of other auditors' work” considering materiality and complexity, we find that the pervasive proliferation of “unconditional” and “presumptively mandatory” responsibilities and stated “responsibilities to consider” (terms as defined per PCAOB Rule 3101) run counter to these declarations. Such declarations make the overall tone of the proposed amendments overly prescriptive in many respects, thus strongly discouraging the exercise of subjective auditor judgments based on such considerations as to the nature and extent of supervisory procedures to be applied. The effect of such prescriptive language will add time to audit engagements to perform unwarranted procedures or to document why they are unwarranted, neither of which will enhance audit quality, and the latter will place the auditor at risk of having his or her judgments second-guessed by PCAOB inspectors or adversary parties in litigation.

Part 2 — Responses to Specific Questions Presented in the 2017 Release

Although we have expressed our most significant views in the foregoing comments (Part 1), our direct responses to the 10 questions presented in the 2017 Release (reproduced in italics below) follow. We have few issues with and generally have not commented as to matters of clarity except to a limited extent primarily in our editorial recommendations in Part 3 of this attachment.

Q1. Is the revised requirement for determining the sufficiency of participation to serve as lead auditor, based on risk and importance of the locations, appropriate and clear?

A1. Subject to the foregoing overriding concerns and reservations contained in Part 1 of this attachment, and except as set forth in the following paragraph and in Q2 and A2, below, we believe the proposed revised requirement for determining the sufficiency of participation to serve as lead auditor would be appropriate if expressed more as guidance than as rigid requirements .

Q2. Is the additional sufficiency threshold for divided responsibility engagements clear? Should this be a bright-line requirement, or does this threshold need to allow for exceptional situations? Are there any other implications of this threshold that the Board should consider, such as investor protection implications or auditing challenges related to the revised requirement?

A2. We believe the Board should not adopt a rigid, bright-line prescriptive sufficiency criterion for dividing responsibility such as it says (on page 10 of the 2017 Release). Accordingly, we believe the last sentence of AS 2101.B2 should be deleted.

Instead, we believe:

- the substance of the discussion that also appears on page 10 (with footnote 10) of the SEC staff expectation and related presumption of a minimum participation by the lead auditor with respect to 50% of assets and revenues (as set forth the Financial Reporting Manual of the SEC’s Division of

² The short 45-day allowable comment period has prevented us from citing specific examples.

Corporation Finance) should be incorporated into the final standard at AS 1206.06³ and referenced from AS 2101.B2: and

- the improbability of overcoming the SEC staff presumption should be more forcefully emphasized and accompanied by a recommendation for the lead auditor to consult the staff of the Division (or the Office of the Chief Accountant) before accepting an arrangement that does not meet that expectation.

Q3. Are the revised requirements relating to the other auditors' compliance with the independence and ethics requirements appropriate? Are there any practical challenges associated with the revised amendments? If so, what are they, and how could the proposed requirements be revised to address the challenges?

A3. We believe the proposed requirement in AS 2101.B4a is impractical and therefore excessive. We observe that it makes no reference to any guidance as to how a lead auditor might overcome a perceived weakness in the other auditor's process for determining compliance with the SEC independence requirements and/or PCAOB independence and ethics requirements when there is no apparent evidence of any possible independence impairment or other ethical violation. (See also para. 1 of Part 3, below.)

Q4. Are the proposed amendments relating to the knowledge, skill, and ability of the other auditor, revised by this release, appropriate? Are there any practical challenges associated with the revised amendments? If so, what are they, and how could the proposed requirements be modified to address the challenges?

A4. We are concerned that the time-consuming process of obtaining information from the other audit firm about its auditors' knowledge, skill, and ability, including the audit firm's policies and procedures for training and assigning personnel, in most cases would likely produce only general, self-serving, highly summarized boilerplate information of little or no value with respect to any audit quality objective. We believe the most effective way to assess competency absent direct prior experience is to rely on personal referrals from trusted sources and regulatory evaluative reports.

Q5. Are the proposed new addition to AS 1015 and revision to AS 1201 relating to the other auditors' responsibility appropriate and clear? Is it clear that AS 1015 already applies to referred-to auditors that perform audits under PCAOB standards?

A5. Since it is clear that other auditors are subject to the ethical requirements of the PCAOB, we believed it is unnecessary to include the note inserted in AS 1015.02 about due professional care. However, although it can be discerned that AS 1015 applies to referred-to auditors, we believe the standard would be improved if such applicability were to be more clearly articulated therein.

Except with respect to multi-tiered audits (see our response below to Q7), we found nothing in proposed revised AS 1201 addressing responsibilities of other auditors, and, subject to the foregoing overriding concerns and reservations contained in Part 1 of this attachment, we find the proposed revisions appropriate.

Q6. Are the proposed new additions to AS 2101.B2 appropriate and clear? Also, is it clear that the necessary level of detail of the other auditor's audit documentation that the lead auditor obtains and the necessary extent of the lead auditor's review according to requirements in proposed Appendix B of AS 1201 are scalable based on the factors in the existing standard regarding the necessary extent of supervision?

A6. See the second paragraph of Part 1 of this attachment for our overriding concerns and reservations about the effect of excessively prescriptive language on scalability.

³ Or referenced there by footnote.

Q7. Are the revised proposed requirements for situations in which the lead auditor directs another auditor to perform supervisory procedures with respect to a second other auditor on behalf of the lead auditor clear? If not, how should the revised proposed requirements be revised?

A7. Subject to the foregoing overriding concerns and reservations contained in Part 1 of this attachment, we find that the proposed requirements relative to multi-tiered audits would be appropriate if expressed more as guidance than as rigid requirements.

Q8. Is the revision to the proposed standard relating to the division of responsibility when the company and its business unit use different reporting frameworks appropriate and clear?

A8. We believe that the revised AS 1206.06d proposed in Appendix 2 of the 2017 Release should be expanded with language that would require that the lead auditor to document the basis for concluding that the auditor who audits the conversion has sufficient knowledge of both reporting frameworks to assume that responsibility effectively.

Q9. Is it clear how the proposed amendments and new standard (as revised by this release) relate to other amendments to auditing standards propose or adopted by the Board since the 2016 proposal?

A9. We believe the revised AS 1201 should address how the lead auditor might deal with critical or key audit matters reported by other auditors and, if not reported as such, how other auditors audited significant estimates or made use of specialists or internal auditors.

Q10. Would any revisions the Board is considering for adoption affect the scalability of PCAOB standards in this area? Would any have a significant effect on the competitiveness of smaller audit firms? Would the revisions significantly change the costs and benefits associated with the proposed changes discussed in the 2016 Proposal? Are there any unintended consequences that the Board should consider? Are there any other matters not addressed in this release the Board should consider in its economic analysis?

A10. See the second paragraph of Part 1 of this attachment for our overall concerns about the effect of overly prescriptive language on scalability.

Although we have no access to any supporting research, our instinctive judgment is that the ability of smaller firms without offices in or near cities where other auditors are based will likely be impaired because they will find it impractical⁴ to perform the extent of supervisory procedures necessary to comply with the revised standard (AS 1201), if adopted as proposed. As further discussed in the following paragraph, such firms will be forced choose the divided responsibility reporting model option provided for in proposed new AS 1206, if available pursuant to the criteria set forth in AS 1206.06 if acceptable to their client(s), or give up the engagement(s) if not. (See also para. 3 of Part 3, below,)

As suggested the bottom of page 9 of the 2017 Release, a predictable consequence we see as likely to be unintended is a shift from the dominant auditor preference (or a bias) of assuming responsibility in favor of making reference to an another auditor in the audit report. The shift would be caused by the burdensome additional supervisory requirements of the lead auditor of proposed AS 1201 that would add significant time and cost to the audit and the risk of liability or regulatory challenges to any risk-based scope decisions that might be made with regard thereto. However, it is likely that many issuers would object to reporting a division of responsibility and, therefore, seek to displace auditors who find it impracticable or impractical to assume full responsibility.

On the other hand, we see a significant risk of regulatory challenge that a decision to divide responsibility would be insufficiently supported by evidence that it was “determined based on the criteria set forth in the

⁴ See para. 3 in Part 3, below.

proposed standard [AS 1206.06],” and that it was “impracticable⁵ for the lead auditor to supervise the work of another audit firm.” The latter consideration is set forth only in the 2017 Release but not in the text of the proposed standard, AS 1206. There is no guidance provided as to how to establish impracticability, so if it is intended that impracticability be established, it should be added to the criteria set forth in AS 1206.06, and such guidance should also be provided.

Part 3 — Editorial Recommendations

1. We believe the word, “determine” (or “determines”), as used in AS 1206.06c and AS 2101.B4 (and there may be other instances) is too strong for most contexts that entail the exercise of judgment. Accordingly, we believe a form of softer word such as “assess” or “evaluate” should be substituted.
2. We believe the language in proposed AS 1206.07a should be clarified as to whether it is, in fact, intended to require the lead auditor to take responsibility for all audit planning and performance away from the other auditor or merely to supplement such work as may be deemed necessary.
3. We believe the word, “impracticable” should not be used in the final release and standard in relation to criteria for determining eligibility to use the division of responsibility reporting option because it is too restrictive but rather that the word, “impractical,” be substituted for it in AS 1206.06 and wherever else it would appear in that regard. Our view is based on the fact that most authorities hold that these two terms are not synonymous (as many people believe) but rather that “impracticable” is more closely synonymous with “impossible,”⁶ than would be appropriate for this context and that “impractical” refers more appropriately, however, to the relative merits of adopting or not adopting a particular course of action. We believe cost-benefit considerations would likely be relevant to assessing impracticality but not impracticability and that such considerations should be significant to a determination of eligibility for division of responsibility reporting.
4. Since risk assessments are inherently subjective, AS 2101.B2 leading into .B2 a and b should end with words like, “the auditor’s judgments as to.”

⁵ *Ibid.*

⁶ Consider the special-purpose definition of “impracticability” contained in Subtopic 250-10-45-9 of the Accounting Standards Codification of the Financial Accounting Standards Board.



November 14, 2017

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, DC 20006-2803

RE: PCAOB Rulemaking Docket Matter No. 042

Dear Madam Secretary:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's ("PCAOB" or "Board") 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* included in PCAOB Release No. 2017-005 (the "release").

We support the PCAOB's consideration of enhancements and the promotion of consistency in the auditor's performance when executing its supervisory responsibilities in an audit involving other auditors. We agree the nature of interaction between the lead auditor and other auditors is important to audit quality, and we support actions that lead to improved communications between auditors. We also support the Board's consideration of a risk-based approach, as we agree the lead auditor's supervision of other auditors should be commensurate with the risks of material misstatement at locations audited by other auditors, as well as the competency of the other auditors.

Overall observations

A number of the proposals addressed within the Supplemental Request for Comment ("SRC") relate to how important matters are addressed when executing complex multi-location audits and require careful evaluation of how best to accomplish the intended objectives in both an effective and efficient manner. In that regard, we note the PCAOB has not included incremental economic analysis (including, for example, a specific discussion of the problems identified and intended to be solved, the characteristics of firms and audits at which such problems have been identified, alternatives considered, or cost, benefits and unintended consequences of various alternatives) of the revised proposed provisions in the SRC. We also believe the proposed changes may not give appropriate consideration to current approaches to multi-location audits (e.g., in relation to scoping and risk assessment). Moreover, some of the increased supervisory responsibilities placed on the lead auditor by the proposals may reduce the time the lead auditor can devote to areas of heightened risk, which become most critical when finalizing the audit.

We have included our preliminary views in this letter, but are concerned that the lack of specificity about the PCAOB's objectives in certain areas impedes our ability to make specific recommendations for finalizing the standard. We believe the issues set out in the SRC would be best resolved by the PCAOB through further outreach and other incremental efforts before the standard is finalized.

A key concern is that the standard is not appropriately scalable and does not take into account certain distinctions that affect how auditors plan and perform their work today to bring quality to multinational audits. The final standard will apply to a range of circumstances in which multi-location audits are conducted and must therefore be capable of being scaled and tailored to varying circumstances. The standard will also apply to a range of firms, including some very large networks of member firms, such as



ours, that have made significant investments in systems of quality control (which must be leveraged in order to be effective given the nature of many of the multinational audit engagements performed by our firm). It will also apply to smaller firms, where more bespoke inquiries and assessments may be more appropriate given the inability or inefficiency to develop and leverage similar systems of quality control. Finally, the standard is intended to address the use of other auditors both within and outside the lead auditor's network – but in our view does not adequately consider the distinctions between these two circumstances.

If the lead auditor and other auditor are members of the same network, we believe the level of effort in applying many of the requirements can be based upon whether the firms have a common methodology, training and monitoring process. In such circumstances, effective network-level processes and controls are an important input to audit quality and should be considered. On the other hand, when the other auditor is not from the same network, we believe there may be practical challenges in complying with a number of requirements, which will be difficult to overcome. Finally, as requirements for mandatory audit firm rotation become effective in some jurisdictions, there is a greater likelihood that firms from different networks will be involved in multi-location audits. This may lead to an increase in divided responsibility because the lead auditor would be unable to obtain information needed to comply with the proposed standard. We do not believe this result would benefit audit quality.

We have suggestions related to what we see as potential practical challenges or areas where additional clarification would be helpful. We have organized our observations and recommendations into the following topical areas:

- I. Independence and ethics
- II. Supervision and review
- III. Referred-to auditors / Divided responsibility
- IV. Other matters

I. Independence and ethics

While we acknowledge AS 2101.06b requires the auditor to determine the audit engagement's compliance with independence and ethics requirements, the requirement to consider the independence of other auditors relies on inquiry, which may include obtaining a written representation. The extant standard is consistent with the reality of the challenges of obtaining or evaluating certain types of information from other auditors, in particular those outside of the lead auditor's network. It also recognizes the inefficiency in asking each lead auditor to make separate assessments of other auditors at a firm level that they are not well-positioned to make. Reliance on a written representation is premised on other auditors' firms having necessary systems of quality control.

Our response to the April 2016 proposal supported requiring the lead auditor to gain an understanding of each other auditor's knowledge and experience in applying the requirements and obtaining a written representation. However, we expressed concerns that the lead auditor's ability to "gain an understanding" may be impacted by whether or not the other auditor is a member of the same network as the lead auditor. These concerns persist, and we do not support the new requirement to "determine an other auditor's compliance with independence and ethics," in particular the revised requirement to "gain an understanding of each other auditor's process for determining compliance with SEC independence requirements and PCAOB independence and ethics requirements." We believe requiring a lead auditor to gain an understanding of each other auditor's process to determine compliance would be costly and



neither effective nor efficient given the complexities of these processes. In particular, individual engagement partners would not be well-equipped to make such assessments. It is the other auditor's professional responsibility to monitor individual compliance, as well as to have a sufficient basis for making written representations about the same.

When the other auditor is not part of the lead auditor's network, practical challenges to gaining an understanding of the other auditor's processes include confidentiality restrictions and concerns with sharing proprietary information. The current proposal does not provide any guidance for lead auditors on how to handle situations in which the lead auditor is unable to obtain information beyond a written representation relating to compliance with independence and ethics requirements, including the information contemplated by AS 2101.B4b(1). In this regard, we note the current communications to audit committees in accordance with PCAOB Rule 3526 focus on independence communications related to the registered accounting firm and its affiliates. The primary auditor's Rule 3526 reporting to the audit committee either includes any covered relationships of any secondary auditors not affiliated with the firm or states that it does not do so.¹ We do not believe the PCAOB intended to change practice to require the inclusion of such relationships of secondary auditors in Rule 3526 communications in all cases and do not recommend doing so.

Our recommendations

We acknowledge the PCAOB's overall objectives of improving audit quality; however, neither the 2016 proposal nor the SRC outlines the specific nature of the concerns with how auditors of large global networks of member firms are currently considering independence in multi-location audits. Accordingly, while we do not believe the proposed requirement would be effective or efficient to implement, it is challenging for us to recommend alternatives without better understanding the PCAOB's specific concerns in this area.

As reflected below, our preliminary suggestion is for the PCAOB to reconsider the proposed requirement in the April 2016 proposal.² We also suggest the PCAOB provide guidance on how firms are expected to perform these procedures when the other auditor is not a member of the same network, as well as guidance on how much additional understanding is necessary when the other auditor is part of the same network and is expected to comply with network-level independence and ethics policies and guidance. Our views on a possible direction of the guidance are as follows:

- If the firms are members of the same network, the level of effort should depend on whether the firms have a similar methodology, training and monitoring process. We believe lead auditors should continue to be able to rely on network processes and controls as long as they have evaluated the results of the network's monitoring of the network firm's compliance with independence and ethics requirements. This would supplement the lead auditor's responsibilities to consider any relevant matters regarding independence raised by other auditors in their written representations.
- When the other auditor is not a member of the same network, we would support requiring the lead auditor to make inquiries of the other auditor to gain the required understanding of the other auditor's knowledge and experience with the SEC independence requirements and PCAOB

¹ See PCAOB Release No. 2008-003.

² See page A1-15 of the April 2016 release.



independence and ethics requirements. The lead auditor would be required to perform additional procedures if it becomes aware of information during the course of the audit in relation to the other auditor's compliance with independence and ethics requirements.

Instead of requiring the lead auditor to gain an understanding of the other auditor's processes, we recommend the PCAOB consider requiring representation from the other auditor that the other auditor's firm has a process in place to assess compliance with applicable independence and ethics requirements, including consideration of relationships that may reasonably be thought to bear on independence. We support the PCAOB's proposal to require each other auditor to provide a written representation as to whether the other auditor is in compliance with the independence and ethics requirements, and for the lead auditor to be expected to perform additional procedures should there be indications that these written representations may not be reliable.

We preliminarily suggest the following changes to the proposed requirement in AS 2101 in light of the concerns and recommendations outlined above:

- .B4 In an audit that involves other auditors, the lead auditor should obtain information about ~~determine~~ each other auditor's compliance with the SEC independence requirements and PCAOB independence and ethics requirements by:
- a. Gaining an understanding of each other auditor's knowledge of ~~(1) process for determining compliance with~~ the SEC independence requirements and PCAOB independence and ethics requirements and ~~(2) their~~ experience in applying the requirements; and

Note: If the lead auditor and the other auditor are members of the same network, the level of effort to gain the required understanding can be based upon whether the firms have a similar methodology, training, and monitoring process related to these areas. In other circumstances, the lead auditor should make inquires of the other auditor to gain the required understanding.

- b. Obtaining a written representation from each other auditor that includes:
 - (1) A statement that the other auditor has appropriate policies and procedures for assessing compliance with SEC independence requirements and PCAOB independence and ethics requirements, including consideration of matters that may reasonably be thought to bear on independence;
 - (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; and
 - (3) A statement written representation that the other auditor ~~it~~ is, or is not, in compliance with SEC independence requirements and PCAOB independence and ethics requirements and, if the other auditor ~~it~~ is not, a description of the nature of any noncompliance.



Note: ~~The lead auditor's determination of each other auditor's compliance with the SEC independence requirements and PCAOB independence and ethics requirements is. The requirements of this paragraph are not limited to preliminary engagement activities and should be reevaluated with changes in circumstances.~~

Note: If the lead auditor becomes aware of information during the course of the audit that (1) contradicts an other auditor's description of its relationships that may reasonably be thought to bear on independence or a representation made by an other auditor regarding its compliance with the SEC independence requirements and PCAOB independence and ethics requirements, or (2) suggests that the other auditor's policies and procedures may not be appropriate, the lead auditor should perform additional procedures to determine the effect of such information on the independence of the other auditor.

II. Supervision and review

While we support the notes that have been added to clarify the intended risk-based approach to supervision, review and the documentation to be obtained by the lead auditor, we believe additional clarification of a number of requirements is necessary. It is important that senior members of the other auditor engagement team be able to assist the engagement partner of the lead auditor in fulfilling his or her responsibilities pursuant to AS 1201 when they have the appropriate knowledge, skill, and ability to do so. In our view, it is generally the other auditors who are in the best position to supervise and execute on the day-to-day responsibilities of the portion of the audit on which they are reporting. We remain concerned that the increased supervisory responsibilities placed on the lead auditor may reduce the time the lead auditor can devote to areas of heightened risk, which could adversely impact audit quality if incremental efforts with little benefit are introduced, especially towards the end of the audit.

Clarifying that other auditors can function as supervisory team members

AS 1201.04 allows the engagement partner to seek assistance from appropriate engagement team members in fulfilling their responsibilities related to the supervision of the audit, including reviewing engagement team members' work ("supervisory team members"). In the April 2016 proposal, the PCAOB indicated that supervisory team members can be from the partner's firm or from outside the firm,³ which we understand can include partners and managers of the other auditors. We believe it is important to explicitly carry this guidance from the release forward and directly incorporate it into AS 1201.

Knowledge, skill, and ability of other auditors

We agree with the description of the lead auditor's expected considerations in accordance with proposed AS 2101.B6b, as this requirement appropriately focuses on "other auditors who assist the lead auditor with planning and supervision." We believe the PCAOB could more explicitly acknowledge that such individuals can also assist the lead auditor in complying with AS 1201.05c in relation to reviews.

The release identifies the lead auditor's own experience working with the other auditor as a possible source of information about the other auditor's knowledge, skill, and ability.⁴ We believe the effort that is necessary to gain an understanding of the other auditor's knowledge, skill, and ability is affected by factors

³ See page 13 of the April 2016 release.

⁴ See page 16 of the release.



such as previous experience with, or knowledge of, the other auditor and the degree to which the lead auditor and the other auditor are subject to common policies and procedures (i.e., within the same network). There are often important network-level policies and procedures, including in relation to common training curriculum and monitoring of quality, that provide the lead auditor with information relevant to considering whether the other auditor has the appropriate knowledge, skill, and ability. We believe these policies and procedures, together with the lead auditor's experience in working with the other auditor, can be leveraged to a great extent. The necessary assessment is likely greatest for new other auditors or, for example, when there are significant changes in senior members of an other auditor's team, and significantly less may be necessary in subsequent years.

Inquiring about other auditors' policies and procedures relating to assignment and training

While we support the requirement in AS 2101.B6b to gain an understanding of the knowledge, skill, and ability of the other auditors who assist the lead auditor with planning or supervision, we are concerned with the proposed requirement in AS 2101.B6a to make inquiries (at the firm level) about other auditors' policies and procedures, including for training. We do not believe inquiries about other auditors' policies and procedures would be necessary or effective in all cases. We believe the lead auditor's risk-based approach to supervision and review is premised on the other auditor making appropriate assignments of significant engagement responsibilities. In addition, how other auditors of non-affiliated firms assign and train individuals may be confidential and proprietary in nature. When not part of the same network, the other auditor's firm is likely to provide a high-level response to inquiries regarding the training and assignment of individuals. Such response may not provide the lead auditor with evidence of the knowledge, skill, and ability of the other auditor. We are therefore concerned this requirement would incur significant time and cost without a commensurate benefit to audit quality. However, we believe the PCAOB could consider requiring the lead auditor to inquire whether the other auditor is satisfied that members of the other auditor's team have the requisite training and experience.

Our recommendations

We suggest a note be added to AS 1201.04 as follows:

- .04 The engagement partner may seek assistance from appropriate engagement team members 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 the standard with respect to the supervisory responsibilities assigned to them.

Note: The supervisory team members can be from the engagement partner's firm or from outside the firm and can include other auditors who assist with planning, supervision, or review.

We suggest the requirement in AS 2101.B6 be amended as follows:

- .B6 At the beginning of an audit that involves other auditors, the lead auditor should:

- a Inquire of about the other auditors' policies and procedures relating to the: as to whether the other auditor is satisfied that appropriate individuals have been assigned to the engagement.



including that they have had sufficient training and experience regarding the relevant financial reporting framework, PCAOB standards and rules, and SEC rules and regulations:

- ~~(1) Assignment of individual 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 an understanding of the knowledge, skill, and ability of the other auditors who assist the lead auditor with planning, ~~or~~ supervision, or review, including their:

...

.c ...

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

Note: The nature and extent of the lead auditor's procedures are affected by various factors, including the lead auditor's knowledge of the other auditor's quality control policies and procedures and the lead auditor's previous experience with the other auditor.

Finally, we believe the language in AS 1201.B1 could cause confusion as to the required approach. It should be clear that the requirements in the appendix to AS 1201 reflect what the PCAOB believes are the requirements to be met when other auditors are involved in the engagement, and not in addition to paragraph .05 of the standard. This could be accomplished with the following edits:

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

Balance of responsibilities between the lead auditor and the other auditor

We note the current requirements in AS 2110.49-.51 with respect to discussions among engagement team members in differing locations regarding risks of material misstatement and believe the PCAOB intends to leverage these requirements in setting out the proposed requirement in AS 1201.B2a(2) related to informing the other auditor of the identified risks of material misstatement.

It is important for the lead auditor to communicate to other auditors their views on significant risks that have been identified and other potential risks of material misstatement that may be relevant to the other auditor's work. But it would not be effective or efficient if the PCAOB were to require the lead auditor to consider all likely sources of potential misstatement ("LSPMs") at the assertion level for each location or business unit where an other auditor performs work. The release appears to at least partially acknowledge this perspective, noting "any risks not identified by the lead auditor in its initial communication to the other auditor would be covered by an existing provision in AS 1201 to instruct the other auditors to bring



any significant auditing issues, including any additional risks of material misstatement identified by the other auditor, to the attention of the engagement partner or other team members who perform supervisory activities.”⁵

In many cases, the lead auditor’s initial risk assessment is a starting point, and, especially with full-scope audits, we would expect the other auditors to have an important role in extending that assessment through to the detailed LSPM level. To illustrate, when scoping a multi-location audit, the lead auditor determines the nature, timing, and extent of other auditors’ involvement by considering the significance of the component and identified risks at the component. When an other auditor is requested to perform a full-scope audit or an audit of specific account balance at a location, and the lead auditor is satisfied as to the other auditor’s knowledge, skill, and ability, we believe the other auditor is best placed to perform the detailed risk assessment at the assertion level and develop appropriate responses to those risks. The lead auditor’s supervision and review would then focus on the documentation from the other auditor provided in accordance with AS 1215.19 and the summary memorandum, and the lead auditor, working with the other auditor, could refine the other auditor’s risk assessment or response as necessary, taking into account the results of procedures at the component or the impact of other efforts by the lead auditor or other auditors, and could request additional documentation as necessary.

Our recommendation

We suggest the following revision to proposed AS 1201:

- .B2 In supervising the work of other auditors, the lead auditor should:
 - a. Inform the other auditor of the following in writing:
 - (1) The scope of work to be performed by the other auditor; and
 - (2) Tolerable misstatement,¹⁹ significant risks and other significant matters affecting the ~~identified~~ risks of material misstatement,²⁰ and, 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.

Information to be obtained from the other auditor

We support the clarifying notes that have been added in AS 1201.B2. We believe the requirement in AS 1201.B2b for the lead auditor to review the other auditor’s description of the audit procedures to be performed should be based on the risk of material misstatement. We also agree that the nature, timing, and extent of documentation to be requested from the other auditor (including planning documentation as well as the summary memorandum) should depend on the lead auditor’s judgment as to the necessary level of review of the work of the other auditor.

Accordingly, we do not envision it would be necessary for the lead auditor to review the nature, timing, and extent of the other auditor’s planned procedures in certain cases. In addition, it would neither be effective nor efficient for the lead auditor to obtain and review a description of the other auditor’s detailed procedures on each financial statement line item. In circumstances when the other auditor is to perform a

⁵ See page 18 of the release.



full-scope audit, and both firms are part of a network with a common methodology, the lead auditor would already have an understanding of the procedures the other auditor would be required to perform in order to provide a full-scope opinion in accordance with the network's methodology. The same would be true when the other auditor is to perform an audit of specific account balance at a location. However, the lead auditor may need to have a greater degree of involvement in directing the other auditor as to the specified procedures that are less than what would be required under the firm's methodology for a full-scope audit or an audit of a specific account balance, to the extent such procedures need to be individually tailored to the engagement.

The release acknowledges that the requirement to obtain a summary memorandum from the other auditor would be generally consistent with existing audit practice.⁶ We think it would be clearer for the standard to explicitly note that the summary memorandum describing the other auditor's procedures, findings, conclusions and, if applicable, opinion could also include the documentation required to be provided in accordance with AS 1215.19. We appreciate the discussion in the release that the form and content of the communications of the results of the work performed by the other auditor can vary depending on the nature of the work performed and whether the communication occurs between affiliated firms in the same network.⁷ However, we have concerns with the new requirement proposed in AS 1201.B2c that directs the other auditor to provide specified documentation for review. As the documentation in the summary memorandum and to comply with AS 1215.19 is often extensive, we believe in many circumstances the lead auditor may not find it necessary to request additional documentation for review. However, we agree with the PCAOB's statement that the lead auditor may need to request from the other auditor and review certain audit documentation in areas involving higher risk or significant judgment.⁸

Separately, as highlighted in our response to the April 2016 proposal, privacy laws of certain jurisdictions may create obstacles for the transfer of the other auditor's documentation from the country in which the other auditor is located to the lead auditor's country. In such circumstances, if the lead auditor determines it necessary to review specified documentation as contemplated by AS 1201.B2c, we believe the lead auditor may need to review such documentation on-site in the other auditor's country. The lead auditor may need to further tailor their approach to supervision and review depending on the challenges that are encountered. For example, we note that many jurisdictions have a statutory requirement for workpapers to be maintained in the local language. This may necessitate the involvement of translators, or the lead auditor could accomplish the objectives of a review through a combination of review of the summary memorandum and documentation in accordance with AS 1215.19 and discussion with the other auditor. We believe it is important for the standard to allow appropriate flexibility in the lead auditor's approach to obtaining, reviewing, and retaining documentation.

Our recommendation

We suggest AS 1201.B2c be deleted and incorporated into .B2d as follows:

~~.B2c Direct the other auditor to provide for review specified documentation with respect to the work requested to be performed;~~

⁶ See page 19 of the release.

⁷ See page 19 of the release.

⁸ See page 21 of the release.



- .B2d Obtain ~~from the other auditor~~ and review a summary memorandum describing the other auditor's procedures, findings, conclusions, and, if applicable, opinion; and consider whether it is necessary to review any additional documentation; and

Note: The lead auditor should inform the other auditor of the necessary level of detail of the other auditor's summary memorandum ~~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 supervision of the other auditor's work by the lead auditor.

Note: The summary memorandum may include the documentation described in AS 1215.19.

III. Referred-to auditors / Divided responsibility

As acknowledged by the PCAOB, many circumstances in which responsibility for the audit is divided relate to significant equity method investees, in which case the lead auditor (or the company) may not have any relationship with the auditor of the equity method investee (i.e., the right or ability to engage with that auditor). We believe the changes proposed to AS 2101.14 likely would not be practicable in these circumstances, in that the lead auditor may not be able to "hold discussions with and obtain information from the [...] referred-to auditors [...] to identify and assess the risks of misstatement..." The release notes these requirements are conditioned on, and limited to, the extent to which such discussion is necessary to identify and assess the risks to the consolidated financial statements associated with the location or business unit.⁹ However, we believe it is necessary for the PCAOB to provide guidance on how the lead auditor would comply with these requirements if direct interaction with an auditor is not possible.

Sufficiency threshold in prospective divided responsibility engagements

We note the PCAOB's statement in the release that the sufficiency criteria proposed to be included in AS 2101.B2 is "analogous to a quantitative threshold that appears in staff guidance set forth in the Financial Reporting Manual of the Securities and Exchange Commission ("SEC") Division of Corporation Finance." We agree the SEC's guidance is appropriate and accommodates exceptional circumstances that occur and are supportive of incorporating the concept into PCAOB standards. However, we question why different language has been introduced, and suggest the SEC's language be used instead to make clear that the PCAOB is not intending to change practice in this regard. Alternatively, the PCAOB should reaffirm in its adopting release that there is no intention to change existing practice as a result of the change in language.

Dealing with different financial reporting frameworks

In response to Question 8, while we believe the SEC's guidance¹⁰ is clear, we would not object to AS 1206 addressing the division of responsibility when the company and its business unit use different reporting frameworks. However, we have a number of concerns with the illustrative examples included in the release and suggest further consideration be given as to how the examples are articulated. Alternatively, the PCAOB could remove these examples and allow the lead auditor to consider the most effective description based on the facts and circumstances.

⁹ See page 28 of the release.

¹⁰ See the *International Reporting and Disclosure Issues in the Division of Corporation Finance*, Item V, *Audit Reports and Independent Auditors*, section J, *References to Another Auditor*.



The example of divided responsibility in AS 1205 does not make reference to an audit of internal control over financial reporting. We believe it is preferable to keep the examples simple, as consideration in these cases would need to be given as to which auditor considered controls related to the conversion adjustments. Additionally, we believe there are instances when the lead auditor divides responsibility in the audit of the financial statements without dividing responsibility in the audit of internal control over financial reporting. One example occurs when dividing responsibility with the auditor of an equity method investee (the most common situation for dividing responsibility today), when internal control over financial reporting relates to the controls over amounts recorded and disclosures made by the company with respect to the equity method investment, not the investee's controls over recording transactions in the investee's accounts.

We note the requirement in AS 1206.08c to "disclose the magnitude of the portion of the company's financial statements [...] audited by the referred-to auditor." Such quantification in relation to the US GAAP totals may be straightforward when the referred-to auditor has audited the conversion adjustments. However, in Example 1, when the lead auditor has audited the adjustments, it seems inconsistent to consider the adjustments in the percentages audited by the referred-to auditor.

Example 1 also includes language noting the lead auditor's opinion is "based solely on the report of Firm ABC" in relation to B Company's financial statements. This example does not appropriately take into account that B Company's financial statements are prepared in accordance with a different financial reporting framework and the lead auditor cannot solely rely on the report on those financial statements. Rather, the lead auditor needs to rely on those financial statements, together with any conversion adjustments to arrive at US GAAP figures. Consideration may also be needed as to whether users of the report can access the conversion adjustments, for example in a footnote or a supplemental schedule.

Our recommendations

We suggest the PCAOB substantially revise the examples related to these circumstances or delete them. We offer a suggestion as to how the examples could be revised in the Appendix, although we recognize the reporting may be handled differently in practice today. We also suggest adding a reference within AS 2101 footnote 25, as well as AS 1301.10d to acknowledge the responsibility for auditing the conversion adjustments.

IV. Other matters

Definitions

The SRC clarifies the lead auditor definition by stating "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."¹¹ We suggest this guidance be incorporated into the standard by adding the following note to the definition of lead auditor in AS 2101.A4 (as well as in other applicable standards where lead auditor is defined):

Note: Individuals working under the lead auditor's guidance and control (which may include secondees from other accounting firms, employees of shared service centers, and other individuals

¹¹ See page 34 of the release.



who work in the role of firm employees) should be treated similar to employees of the lead auditor's firm for purposes of defining the lead auditor.

We suggest clarifying the definition of other auditors in AS 2101.A4 and AS 1201.A5 to specify the level (i.e., firm or individual from that firm) at which the PCAOB expects the lead auditor to apply the proposed requirements. Specifically, footnote 20 from page 12 of the Release should be incorporated into the proposed standard as follows:

Note: The proposed definition of "other auditor" includes both a firm and individuals from that firm. As a practical matter, this requirement would typically be applied at the firm level because the other auditor firm would typically have both the processes for determining compliance with PCAOB independence and ethics requirements and SEC independence requirements and some level of experience in applying those requirements. This requirement would be applied at the individual level for participating persons who are not part of a firm.

We note this footnote explicitly relates to application of the requirements in relation to independence and ethics. However, we believe this clarification of the level at which the standard applies would be important in relation to other proposed amendments (e.g., AS 2101.B6). The PCAOB should be clear that, when it is possible to perform certain procedures at a firm level, it does not expect the lead auditor to perform those procedures for individual members of the other auditor's engagement team, as this could result in unnecessary effort and cost.

Multi-tier audits

Paragraph 1201.B3 addresses circumstances in which an other auditor might assist the lead auditor in supervising a second other auditor. This requirement appears likely to create inefficiencies within the audit process by duplicating review of the second other auditor's work by the lead auditor without considering the fact that the first other auditor is normally in the best position to supervise and review the second other auditor, as well as to determine the scope of the audit, and identify risks of material misstatement at the second other auditor's location.

We recommend the proposal be amended to indicate that the nature and extent of the lead auditor's review of the work performed by the second other auditor should be determined by the lead auditor using a risk-based approach to ensure all auditors participating on the engagement are focused on the right work at the right time. The involvement of the lead auditor should vary depending on the risks associated with the audit performed by the second other auditor. In addition, the level of documentation (if any) to be obtained from the second other auditor should be left to the judgment of the lead auditor. For example, in lower risk situations, the lead auditor may be able to rely on the sufficiently detailed reporting of the first other auditor to the lead auditor (which is premised on the first other auditor reviewing the relevant documentation from the second other auditor). In higher risk situations, the lead auditor may consider it appropriate or necessary to review the summary memorandum of the second other auditor.

Determination to serve as the lead auditor

In response to Question 1, we support the change to AS 2101.B2b for the lead auditor to consider the importance of the locations or business units in determining the sufficiency of participation to serve as the lead auditor. It is our experience that, due to qualitative reasons, the firm in the best position to be the lead auditor may not audit the largest portion of the financial statement line items individually or in the



aggregate. However, the release notes the Board has considered, but preliminarily rejected, including audit firm factors as criteria in the sufficiency determination (e.g., where the firm is licensed).¹² We believe it is important for the standard to consider the fact that, in certain jurisdictions (including within the US), law or regulation requires an auditor licensed in the jurisdiction to sign the auditor's report. This could create conflicts in determining the signing firm as compared to which firm might otherwise be determined to be the lead auditor, for example as a result of the company's operations primarily being outside the jurisdiction in which the auditor's report must be signed. In our view, this is a qualitative consideration that must be taken into account to find a solution that appropriately considers audit quality.

Due professional care

In response to Question 5, the proposed additions to AS 1015 and revisions to AS 1201 relating to the other auditor's responsibilities are appropriate and clear. Additionally, it is clear that AS 1015 already applies to referred-to auditors that perform audits under PCAOB standards.

Equity method investees

Further to our concern about the potential inability to interact with a referred-to auditor described in section III of this letter, we also question whether it is appropriate to view the auditor of an equity method investee in the same way as an other auditor, in particular if the other auditor is not within the lead auditor's network.

Interaction with proposals related to auditing accounting estimates

As outlined in our August 30, 2017 response to PCAOB Rulemaking Docket Matter No. 043, we have significant concerns as to how the proposed changes to AS 1105, *Audit Evidence*, have been articulated in relation to the valuation of investments based on investee financial condition or operating results. That response highlights our view that it may not be possible for the company's auditor to compel an investee's auditor to perform additional procedures given the lack of a relationship between the two. As drafted, certain requirements in paragraphs .A4 and .A5 of AS 1105 would result in an approach similar to situations that involve the auditor's supervision of other auditors, which may not be appropriate in certain circumstances, as we described above. We believe the PCAOB should consider our comments on both proposals holistically as it moves forward with its proposal related to other auditors, in particular in the context of equity method investees.

Effective date

Page 44 of the release notes the Board is considering whether compliance with an adopted standard and amendments should be required for audits of fiscal years beginning in the year 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). Given the potential impact of the proposals on the lead auditor's approach to planning and risk assessment, as well as the communications with other auditors, we believe the PCAOB should allow for implementation to take place over a minimum of two audit cycles (i.e., the proposals should become effective no sooner than for audits of fiscal years beginning two years after the year of SEC approval). Adequate lead time allows for firms to effectively implement the proposals, including training to the practice for both lead auditors and other auditors, which benefits audit quality.

¹² See page 11 of the release.



Coordination with the International Auditing and Assurance Standards Board (IAASB)

We note the IAASB has a project on its agenda to consider revisions to ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*. It is in the public interest to reach solutions that can bring about consistent, high-quality auditing standards when addressing the same or similar subject matters and auditing concepts. We encourage the PCAOB to engage in dialogue with the IAASB as the PCAOB moves forward in finalizing their proposal given the impact on firms' methodologies of having divergent standards addressing multi-location audits.

* * * * *

We appreciate the opportunity to express our views and would be pleased to discuss our comments or answer any questions that the PCAOB staff or the Board may have. Please contact Leonard Combs (973-236-5265) regarding our submission.

Sincerely,

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP



Appendix

We suggest the following changes to the examples in AS 1206.

Example 1: Conversion Adjustments Audited by 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, which were audited by Firm ABC, were 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, insofar as they relate 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 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 of constituting \$XX percent and \$YY percent of consolidated assets as of December 31, 20X3 and 20X2 (subsequently adjusted by the Company to US GAAP amounts of \$XX and \$YY), respectively, and total revenues of constituting \$XX percent, \$YY percent, and \$ZZ percent of consolidated revenues for the years ended December 31, 20X3, 20X2, and 20X1 (subsequently adjusted by the Company to US GAAP amounts of \$XX, \$YY, and \$ZZ), respectively. We have audited the adjustments necessary to convert the financial statements of B Company to conform those financial statements to accounting principles generally accepted in the United States of America.

Example 2: Conversion Adjustments Audited by 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, which were prepared under [name of financial reporting framework used by B Company] and included a footnote, the adjustments to conform adjusting 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 opinions, insofar as they relate 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 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, respectively, and total revenues constituting XX percent, YY percent, and ZZ percent of consolidated revenues for the years ended December 31, 20X3, 20X2, and 20X1, respectively.



November 14, 2017

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Public Company Accounting Oversight Board
1666 K Street N.W.
Washington, D.C. 20006-2803

RSM US LLP

One South Wacker Drive
Suite 800
Chicago, IL 60606
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Re: PCAOB Rulemaking Docket Matter No. 042 – Release No. 2017-005

Dear Office of the Secretary:

RSM US LLP appreciates the opportunity to offer our comments on PCAOB Release No. 2017-005, *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.”* RSM US LLP is a registered public accounting firm serving middle-market issuers, brokers and dealers.

With respect to audits involving other auditors, we continue to support a risk-based supervisory approach focused on significant risks to the consolidated financial statements. The amendments, as proposed to date, have made some strides in that regard, but we believe there are additional opportunities to further promote a principles-based focus on the significant risks, while also allowing the lead auditor to exercise professional judgment in varying the nature, timing and extent of supervisory activities so as to provide for a more effective and efficient audit.

We also support the Board’s recent revision that would amend AS 1015, *Due Professional Care in the Performance of Work*, to include a statement that other auditors are responsible for performing their work with due professional care, which concerns what the independent auditor does and how well he or she does it.¹ We believe the overwhelming majority of auditors take the responsibility for due professional care very seriously because they understand that the quality of an audit needed to inspire investor confidence is built on the integrity, competence, objectivity and independence of our profession. We note, however, that certain proposed requirements do not rely on this important premise, but rather, in some instances seem to expect lead auditors to “audit” the other auditor’s integrity, competence, objectivity and independence. Although the lead auditor’s supervision of the other auditor must involve proper instruction and review, we believe there are areas in which audit quality is best served by the lead auditor relying on the representations made by the other auditor about engagement-specific matters, rather than by requiring the lead auditor to obtain evidence about matters related to the other auditor’s system of quality control.

Our comments with respect to the proposed amendments demonstrate how the concept of due professional care can be used effectively in the lead auditor’s supervision of the other auditor. Our comments also address other potential enhancements to the risk-based supervisory approach for audits that involve other auditors. Further, we have commented on the effective date of the proposed new auditing standard and amendments.

¹ See paragraph .04 of AS 1015 on page A1-9 of the Release.

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Determination to serve as lead auditor (sufficiency of participation)

In the Release, the Board states it is considering revising the provisions for assessing a prospective lead auditor's sufficiency of participation to expressly require consideration of the importance of the locations or business units audited by the lead auditor. We believe the concept of "importance" already is factored into the auditor's consideration of the risks of material misstatement associated with the portion of the financial statements audited by the lead auditor as required in paragraph .B2.a. of AS 2101, *Audit Planning*. Including importance as an additional consideration would be confusing to apply in practice because "importance" is not defined in the auditing standards; whereas, the consideration of the risks of material misstatement is a familiar concept for auditors and is well supported by the auditing standards. We therefore suggest that paragraph .B2.b. of AS 2101 be deleted.

The Board also is considering adding to paragraph .B2 of AS 2101 another sufficiency threshold to be met by the lead auditor in prospective divided-responsibility engagements as follows:

In addition, the participation of the engagement partner's firm to serve as lead auditor ordinarily is not sufficient if the referred-to auditors, in aggregate, audit more than 50 percent of the company's assets or revenues.

So as to eliminate possible confusion, we believe it would be beneficial if this sufficiency threshold was consistent with the guidance provided for auditors in Section 4140.1 of the SEC Division of Corporation Finance Financial Reporting Manual, and therefore suggest that paragraph .B2 of AS 2101 be revised to read as follows:

Generally, the lead auditor is expected to have audited or assumed responsibility for reporting on at least 50% of the assets and revenues of the consolidated entity.

Other auditors' compliance with independence and ethics requirements

We believe the revisions to the proposed requirements in paragraph .B4.a. of AS 2101, which, if finalized, would require the lead auditor to understand each other auditor's "process for determining compliance" with the SEC independence requirements and PCAOB independence and ethics requirements and experience in applying the requirements, would not be practical to implement for the following reasons:

- Given that the proposed definition of "other auditor"² includes both a firm and individuals who are members of the engagement team, proposed paragraph .B4.a of AS 2101 would require the lead auditor to determine each individual's process for compliance with the independence and ethics requirements. This could entail interviewing all engagement team members and obtaining their requisite records. We do not believe this requirement is practical due to the amount of time involved and the fact that it would be duplicative of what the other auditor firm would already be doing to determine whether individual members of the engagement team are compliant with the requisite independence and ethics requirements. We do not believe such an approach provides a benefit to investors that is commensurate with any potential improvement to audit quality resulting from, or the extensive cost involved with, performing the necessary procedures to comply with the requirement.

² See the proposed definition of "other auditor" in paragraph .A5 of AS 2101 on page A2-10 of the Release.

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- If proposed paragraph .B4.a. of AS 2101 is interpreted to mean that the lead auditor needs to gain an understanding of the other auditor firm's process for determining compliance (i.e., not the individual's process), we do not think the requirement is practical, given the complexity of, and differences in, each firm's process for determining such compliance. To obtain an understanding of an audit firm's process for determining compliance with independence and ethics requirements would require extensive inquiry of the individual at the firm who is responsible for such matters and also would require reading the firm's policies governing such a process, which, in many instances, could be volumes of material. We do not believe such an approach provides a benefit to investors that is commensurate with any potential improvement to audit quality resulting from, or the extensive cost involved with, performing the necessary procedures to comply with the requirement.
- Paragraph .B4.b(2) is too broadly written and could be interpreted to mean that the other auditor would need to provide the lead auditor with a description of any independence violation related to any client. This would violate client confidentiality requirements and not be relevant to the engagement.

We believe the other auditors' compliance with independence and ethics requirements is best addressed at the engagement level and in reliance upon the due care requirements in AS 1015. We therefore suggest revising paragraph .B4 of AS 2101 to read as follows (proposed deletions are struck through, and proposed additions are shown in bold font):

- .B4 In an audit that involves other auditors, the lead auditor should determine each other auditor's compliance with the SEC independence requirements **relative to the audit client** and PCAOB independence and ethics requirements **relative to the audit client** by:-
- ~~a. Gaining an understanding of each other auditor's (1) process for determining compliance with the SEC independence requirements and PCAOB independence and ethics requirements and (2) experience in applying the requirements; and~~
- ~~b. Obtaining~~ **obtaining** from each other auditor:
- a. ~~(1)~~ 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; and
- b. ~~(2)~~ A written representation that it:
- (1) **Has appropriate policies and procedures in place for determining compliance with SEC independence requirements and PCAOB independence and ethics requirements;**
- (2) **Has prepared a self-assessment of compliance with SEC independence requirements relative to the audit client and PCAOB independence and ethics requirements relative to the audit client in accordance with the applicable quality control standards; and**
- (3) ~~is~~**is**, or is not, in compliance with SEC independence requirements **relative to the audit client** and PCAOB independence and ethics requirements **relative to the audit client** and, if it is not, a description of the nature of any non-compliance.

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Other auditors' knowledge, skill and ability

If finalized, newly proposed paragraph .B6.a. of AS 2101 would require the lead auditor to inquire about other auditors' policies and procedures relating to the (a) assignment of individuals to audits conducted under PCAOB standards; and (b) 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. On page 15 of the Release, the Board explains the rationale for this new requirement:

By understanding the other auditor's policies and procedures for training and assigning its personnel, the lead auditor would be in a better position to identify matters that may warrant further attention. For example, if non-supervisory team members are not required to be trained on PCAOB standards, the lead auditor may decide to obtain additional information about the knowledge, skills, and ability of personnel performing important audit tasks in determining the necessary extent of supervision of their work.

We believe it is the responsibility of supervisory team members to ensure that non-supervisory team members have the requisite knowledge, skill and ability to perform the duties assigned to them. We therefore believe it is unnecessary for the lead auditor to perform the procedures proposed in paragraph .B6.a.of AS 2101 as such procedures would be duplicative of what supervisory team members would do. Further, if the auditor were to perform such procedures and identified matters that warranted further attention, we do not believe it would be practical for the other auditor to "obtain additional information" about such matters for "personnel" because:

- It is difficult for the lead auditor to determine what would be sufficient evidence to demonstrate the knowledge, skill or ability of the individuals. For example, if an individual had a week of training related to PCAOB standards, would that be adequate? Or, should the individual have had two weeks of such training during their career? Would the lead auditor need details about the content of such training?
- Laws in certain jurisdictions, as well as internal firm policies, may prohibit the sharing of confidential employee information outside of the firm.
- We do not believe such an approach provides a benefit to investors that is commensurate with any potential improvement to audit quality resulting from, or the extensive cost involved with, performing the necessary procedures to comply with the requirement.

For these and other reasons, it has been customary for the lead auditor to ask probing general questions about the knowledge, skill and ability of the other auditor, given the scope of the audit, the client's industry and the standards under which the audit is to be performed, among a myriad of other considerations. This dialogue allows the lead auditor to gain an understanding of the knowledge, skill and ability of the other auditors who assist the lead auditor with planning or supervision and who therefore will be responsible for the assignment of individuals to the audit and for ascertaining that those individuals have the requisite training. This manner of asking questions of, and receiving acknowledgments from, the other auditor to determine the other auditor's qualifications is congruent with the notion that other auditors are responsible for performing their work with due professional care.³

³ See the proposed note to paragraph .02 of AS 1015 on page A1-8 of the Release.

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We therefore recommend deleting paragraph .B6.a. of AS 2101. If the paragraph is retained, we believe it would be helpful if the amendments would clarify in the definition of “other auditor” the notion that requirements typically would be applied at the firm level, and only would be applied at the individual level for participating persons who are not part of a firm.

Supervising the work of other auditors

Tolerable misstatement

Proposed paragraph .B2.a. of AS 1201, *Supervision of the Audit Engagement*, would require the lead auditor to “Inform the other auditor of...tolerable misstatement.” It appears it is the Board’s intention to require the lead auditor to inform the other auditor of the “tolerable misstatement for the location or business unit.”⁴ Therefore, we suggest that paragraph .B2.a. be revised to specify that the required communication is the tolerable misstatement for the location or business unit.

Identified risks of material misstatement

Proposed paragraph .B2.a.(2) of AS 1201 requires the lead auditor to “Inform the other auditor of...the identified risks of material misstatement.” This requirement then becomes the basis for further supervision and review by the lead auditor and for the summary memorandum to be provided by the other auditor. We believe a risk-based approach would not require the communication of all identified risks of material misstatement because not all identified risks of material misstatement will necessarily be applicable to a particular location or business unit and therefore could unintentionally require additional unnecessary procedures by the other auditor. We suggest instead requiring the lead auditor to inform the other auditor of identified *significant* risks of material misstatement *at the entity and business unit level*.

Reviewing the other auditor’s work

Proposed paragraph .B2.b of AS 1201 requires the lead auditor to “Obtain and review the other auditor’s description of the audit procedures to be performed...” We believe this revised new proposed requirement would involve the performance of a review at a level of detail that may not be necessary or effective in all circumstances. For example, it may not be necessary for the lead auditor to obtain the entire audit program from the other auditor when the other auditor performs a full-scope audit for statutory purposes. We believe a more effective and efficient risk-based approach would instead be limited to requiring the lead auditor to obtain and review the other auditor’s description of the nature, timing and extent of audit procedures to be performed in response to identified significant risks of material misstatement at the entity and business unit level.

Likewise, proposed paragraph .B2.d. of AS 1201 would require the lead auditor to “Obtain from the other auditor a summary memorandum describing the other auditor’s procedures, findings, conclusions, and, if applicable, opinion...” We believe a more effective and efficient risk-based approach would instead be limited to requiring the lead auditor to obtain a summary memorandum describing the other auditor’s (a) procedures performed in response to identified significant risks of material misstatement at the entity and business unit level, together with related findings and conclusions; and (b) opinion, if applicable.

Multi-tiered audits

In a multi-tiered audit, proposed paragraph .B3 of AS 1201 requires the lead auditor, in supervising the first other auditor, to “evaluate the first other auditor’s supervision of the second other auditor’s work.”

⁴ See page A4-31 of PCAOB Release No. 2016-002, *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard—Dividing Responsibility for the Audit with Another Accounting Firm*.

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However, the next sentence in that paragraph appears contradictory to the preceding one as it extends the lead auditor's responsibilities beyond evaluating the first other auditor's supervision by requiring the lead auditor to "obtain, review, and retain a copy of the summary memorandum provided by the second other auditor to the first other auditor."

We disagree with the revision to the proposed amendments that would require the lead auditor to obtain, review and retain a copy of the summary memorandum provided by the second other auditor to the first other auditor in a multi-tiered audit. We believe the lead auditor should evaluate the first other auditor's supervision of the second other auditor, but that evaluation should be limited to the lead auditor's review of the information provided by the first other auditor to the lead auditor. In our view, the proposed requirement for the lead auditor to review and retain a copy of the summary memorandum provided by the second other auditor (a) implies that the supervision of the second other auditor by the first other auditor is inadequate; (b) would cause duplicative efforts that would not necessarily improve audit quality; and (c) removes an important exercise of judgment by the first other auditor in discerning which matters are most important to communicate to the lead auditor.

We therefore suggest paragraph .B3 of AS 1201 be revised to read as follows (proposed deletions are struck through, and proposed additions are shown in bold font):

.B3 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 subunit audited by a second other auditor. As another example, an other auditor might assist the lead auditor in supervising a second other auditor. In these situations, the lead auditor may direct the first other auditor to perform the procedures in paragraph .B2 with respect to the second other auditor on behalf of the lead auditor, 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. **In performing this evaluation, the lead auditor may request information provided by the second other auditor to the first other auditor, as deemed necessary in the lead auditor's judgment.** ~~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 1215.10.~~

Dividing responsibility for the audit with another accounting firm

We agree with the revisions, which now would allow for division of responsibility when financial reporting frameworks are different, as we believe this is an important option that should be allowed to accommodate situations in which a foreign subsidiary's financial statements are prepared in accordance with International Financial Reporting Standards and audited by an other auditor and the consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles.

Communication with audit committees

The Board has proposed revising paragraph 10.e. of AS 1301, *Communication with Audit Committees*, so that the lead auditor is required to communicate to the audit committee the basis for determining the sufficiency of its participation only if significant parts of the audit are performed by other auditors or referred-to auditors. Although this proposed revision is intended to require communication about the

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sufficiency determination when it is most meaningful, we believe it will lead to diversity in practice because the word “significant” is not defined in the requirement. We therefore suggest the paragraph be revised to read as follows (proposed deletions are struck through):

- e. In an audit that involves other auditors or referred-to auditors, the basis for the engagement partner's determination that the participation of his or her firm is sufficient to serve as the lead auditor, ~~if significant parts of the audit are to be performed by other auditors or referred to auditors.~~

Effective date

If finalized, the proposed new auditing standard and amendments will require audit firms a considerable amount of time to develop and implement effective quality control procedures and related training. Also, the new requirements likely will require extensive discussions with other auditors as implementation of the new requirements is evaluated. Due to the extent of these efforts, we believe it would be prudent for the proposed new auditing standard and amendments to be effective for audit periods ending two years after the SEC approves the final standard.

We would be pleased to respond to any questions the Board or its staff may have about our comments. Please direct any questions to Sara Lord, National Director of Audit Services, at 612.376.9572.

Sincerely,

RSM US LLP

RSM US LLP



ICAEW REPRESENTATION

129/17

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*

ICAEW welcomes the opportunity to comment on the Supplemental Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard — *Dividing Responsibility for the Audit with Another Accounting Firm* published by PCAOB on 26 September 2017, a copy of which is available from this [link](#).

This response of 15 November 2017 has been prepared on behalf of ICAEW by the Audit and Assurance Faculty. Recognised internationally as a leading authority and source of expertise on audit and assurance issues, the Faculty is responsible for audit and assurance submissions on behalf of ICAEW. The Faculty has around 7,500 members drawn from practising firms and organisations of all sizes in the private and public sectors.

ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 147,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

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MAJOR POINTS

1. We welcome these supplemental proposals relating to the supervision of audits involving other auditors and the proposed auditing standard on dividing responsibility for audits with other accounting firms. The audit of group financial statements is, increasingly, a technically and logistically complex exercise.
2. We welcome the fact that the PCAOB has taken account of comments received on its 2016 consultation and is considering revising its proposals as a result of those comments. In particular, we welcome:
 - the removal of the proposed requirement for lead auditors to record a description of other auditor documentation reviewed but not retained;
 - the removal of the proposed requirement for certain communications to be made directly between lead auditors and second other auditors, bypassing first other auditors;
 - the acknowledgement that summary memoranda are widely used in practice and that a good audit trail is important in any audit involving more than one auditor, but that the content of summary memoranda vary extensively depending on individual circumstances.

More use of first other auditors will result in greater efficiency and, potentially, effectiveness

3. The revised proposed requirements are an improvement but there is still scope for better use of first other auditors in multi-tiered audits without compromising audit quality. For example, the revised proposed requirement for lead auditors to obtain, review and retain a summary memorandum from second other auditors through the first other auditor, rather than directly from the second other auditor is a step forward but it is still far from reflective of the manner in which companies and their auditors actually operate.
4. We fully acknowledge the need for lead auditors to engage with second other auditors directly without reference to first other auditors. Simply relying on controls without testing them or performing substantive checks around them is not enough. In any business, those with high level responsibilities must attend to the reports of those they appoint to manage business activities but from time to time they must also ‘walk the floor’, to understand what is actually happening and to encourage diligence in reporting. But if the need to check is paramount and the controls designed to form a basis for trust are never tested, such controls become redundant, or duplicative at best. There is little point in appointing a layer of middle management if senior management ignores it and continues to manage the business as if it was not there.
5. Control systems necessarily cascade responsibilities through a hierarchical reporting structure to be efficient and effective. If the attempted span of control at a high level is too wide, it fails and it is impossible to control everything from the top. The revised requirements would be therefore be further improved if they acknowledged more clearly the critical role of the risk assessment that is, in practice, carried out at all levels. The PCAOB should acknowledge properly the ability of first other auditors to effectively supervise and monitor second (and more) other auditors.
6. Lead auditors will in practice make use of the lines of responsibility and reporting in multi-tiered audits in performing their risk assessments and determining their responses. They will focus on the summary memoranda obtained from first other auditors, which in turn will cover the work of

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second other auditors. Summary memoranda are in practice ‘cascaded up’ through reporting hierarchies. If the PCAOB also requires lead auditors to obtain, review and retain summary memoranda from second other auditors, they will of course do so, but as a compliance exercise and in a perfunctory manner, because that is what the PCAOB expects, and what PCAOB inspectors will seek to inspect. The matters covered in those memoranda will already have been covered off. Similar considerations apply in respect of compliance with independence and other ethical requirements.

The rebuttable presumption

7. Situations in which audit firms find that they have responsibilities as lead auditors but very little involvement in the audit of the group as a whole are not uncommon, as a result of mergers, acquisitions, changes in auditors and independence requirements. Support within auditing standards to help auditors obtain appropriate audit evidence in such situations is necessary. Within International Standards on Auditing (ISAs), the principal mechanism by which this is achieved is by requiring the same level of work effort and quality of audit evidence by lead auditors, regardless of their level of involvement.
8. The immediate consequences of the proposed rebuttable presumption that lead auditors should audit 50% of assets and revenues in divided responsibility situations are likely to be insignificant. As the PCAOB notes, divided responsibility remains relatively rare (at least for the time being), the area is already covered by an SEC rule and the 50% threshold represents common industry practice. It is clearly in the public interest that lead auditor involvement is adequate, and at first glance, the 50% rebuttable presumption makes sense. Nevertheless, we have to date opposed any such suggestions because they rarely, if ever, operate as intended. The proposal focuses disproportionate attention on a very narrowly scoped area and despite the Board’s best intentions it is likely to be misinterpreted as a bright-line rule.
9. It would therefore be helpful for the PCAOB to make it clear that it does not intend to effectively prohibit situations in which lead auditors audit less than 50% of the group as a whole, and that its intention is to require auditors to make a good case in such situations. A note within the standard and/or a staff publication discussing cases already identified by the PCAOB of situations in which it may be appropriate to rebut the presumption would be helpful. Those identified by the PCAOB include late stage mergers and acquisitions but there are more. The discussion should cover other factors affecting the decision such as the use of shared service centres, equity method investments and joint ventures, and auditor rotation requirements.
10. A further unintended consequence is likely to be further negative pressure on competition in the audit market. This is less of an issue in the USA than elsewhere but a limited choice of auditors for US businesses located outside the USA affects US investors.

Divided responsibility

11. The Board at one and the same time appears to acknowledge that divided responsibility causes little mischief - it states that there are relatively few such audits - but then goes on to deal with the issue as if it believes it is a problem, or is likely to become one. It notes a belief among some commenters that the number of such engagements is likely to increase.
12. We respectfully suggest that while it may sometimes be difficult for lead auditors to supervise the work of other firms, and a specific audit approach may be impracticable in a specific area for a specific entity, it is rarely if ever wholly ‘impracticable’ for lead auditors to supervise other auditors. We do not believe that divided responsibility serves US investors well and we do not believe that the PCAOB should continue to support a differential approach to divided responsibility, still less extend it to situations in which different financial reporting frameworks are in use.

RESPONSES TO SPECIFIC QUESTIONS

Q1: Is the revised requirement for determining the sufficiency of participation to serve as lead auditor, based on risk and importance of the locations, appropriate and clear?

13. The proposed revised requirement for lead auditors to consider the importance (quantitatively and qualitatively) of the locations or business units on which they perform procedures, in relation to the financial statements as a whole, seems reasonable. We believe that auditors generally do this already but it is helpful to have it set out in auditing standards for auditors negotiating with clients in situations in which lead auditors have relatively little participation in the wider group audit.

Q2: Is the additional sufficiency threshold for divided responsibility engagements clear? Should this be a bright-line requirement, or does this threshold need to allow for exceptional situations? Are there any other implications of this threshold that the Board should consider, such as investor protection implications or auditing challenges related to the revised requirement?

14. We note in our main points above our belief that the immediate consequences of the proposed rebuttable presumption that lead auditors audit 50% of assets and revenues are likely to be insignificant but that despite the PCAOB's best intentions, the proposal:

- focuses disproportionate attention on a very narrowly scoped area and is open to misinterpretation as a bright-line rule;
- is likely to result in additional pressure on competition in the audit market which affects many US investors who have interests in US businesses with operations outside the USA.

15. ICAEW has to date opposed such proposals because they rarely, if ever, operate as intended. It would therefore be helpful for the PCAOB to make it clear that it does not intend to effectively prohibit situations in which lead auditors audit less than 50% of the group as a whole and that its intention is to require auditors to make a good case in such situations. A note within the standard and/or a staff publication discussing cases already identified by the PCAOB of situations in which it may be appropriate to rebut the presumption would be helpful. Those identified by the PCAOB include late stage mergers and acquisitions but there are more. The discussion should cover other factors affecting the decision such as the use of shared service centres, equity method investments and joint ventures, and auditor rotation requirements.

16. More generally, we do not believe that divided responsibility serves US investors well and we do not believe that the PCAOB should continue to support a differential approach to divided responsibility, still less extend it to situations in which different financial reporting frameworks are in use. It may be difficult for lead auditors to supervise the work of other firms in some cases, and a specific audit approach may be impracticable in a specific area for a specific entity, but it is rarely if ever wholly 'impracticable' for lead auditors to supervise other auditors.

Q3: Are the revised requirements relating to the other auditors' compliance with the independence and ethics requirements appropriate? Are there any practical challenges associated with the revised amendments? If so, what are they, and how could the proposed requirements be revised to address the challenges?

17. On the face of it, the proposed revised requirement for auditors to understand the other auditor's *process* for determining compliance with independence and other ethical requirements and the other auditor's experience in applying them, may seem more robust than

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a simple requirement to understand the other auditor's knowledge of the requirements. Large firms routinely require auditors to look at both process and the outcome. But what matters more? The fact that the other auditor has been through a process, or whether the other auditor actually understands and has applied the requirements? It is easier for PCAOB inspectors to challenge process than it is to challenge lead auditor judgements regarding other auditor compliance with ethical requirements but the latter is important. Lead auditor understanding of other auditors' supervisory staff compliance with independence and other ethical requirements on an individual basis is important. Lead auditors need to know, for example, if senior staff at the other auditor have been disciplined by local regulators.

18. Requiring auditors to *understand* the other auditor's knowledge can be seen as a more far-reaching requirement. It can be interpreted as going further than the broader, more superficial requirement to understand process. This is the position firms believe they are in now. Lead auditors seek to understand compliance using questionnaires, following up on answers that do not make sense. **Might it be better to look at process as a means to an end, rather than an end in itself, and to marry the original proposals with the proposed revisions by requiring lead auditors to understand the other auditor's process for determining compliance and experience in applying the requirements *in order to understand the other auditor's knowledge and application of the requirements?***
19. The regulatory approach to independence and other ethical requirements is critical. The PCAOB states that it does not 'currently' intend to prescribe how firms go about understanding the other auditor's process but then, by implication, goes on to describe what it might prescribe, i.e. obtaining a written description of the process and results thereof, or through inquiry and performing appropriate follow-up procedures to address gaps. If this is what the PCAOB wants lead auditors to do, it should say so in the standard itself rather than leaving it to PCAOB inspectors to make this clear. The PCAOB also describes factors affecting the necessary effort to obtain the understanding of the other auditor's process and experience, such as the lead auditor's existing knowledge. Again, there seems to be little reason why this should not be included as a note in the standard itself.
20. The proposed revised requirement to obtain a representation from the other auditor *that it is, or is not, in compliance* with independence and other ethical requirements, and if not to obtain a description of the nature of any non-compliance is clear.
21. However, the proposed revised requirement for lead auditors to obtain a written description from each other auditor regarding relationships with the entity or persons in financial reporting oversight roles that may reasonably be thought to bear on independence is more problematic. The significance of a relationship between auditors and persons in financial reporting oversight roles at a component may be different to such a relationship at group level and we do not believe that there is any need to identify such relationships on a blanket basis *unless* the risk assessment indicates otherwise. Again, the risk is that auditors will obtain the information, at a cost, for inspection purposes only and that it will be of little relevance to the 'real' audit.
22. The proposals state that the Board has preliminarily decided not to allow 'reliance' on networks in determining the other auditor's compliance with independence and other ethical requirements. This statement needs some unpacking and we urge the PCAOB to open up a more nuanced and mature discussion of this important area. The IAASB's project on group audits is looking very carefully at this area and we urge both bodies to engage both with each other, and with audit firms on this issue.
23. Even firms that have tightly integrated networks and robust quality controls do not allow auditors to assume that because another network firm has performed the audit, the audit approach taken is appropriate, the audit evidence obtained can be taken at face value and compliance with ethical requirements can be taken as read.

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24. We understand that the IAASB is currently intending to acknowledge the existence of network wide controls in group audits, and to require lead auditors to take a robust approach to obtaining appropriate evidence regarding the design, implementation and operating effectiveness of network controls in situations in which a modified audit approach is proposed on the basis that network controls are operating effectively. We urge the PCAOB to engage in these discussions rather than to close the issue.
25. In our response to the original 2016 proposals dated we do not use the word ‘reliance’ in the context of networks. We stated, and we re-iterate the following:

The overall impression given reading the proposals is that that the PCAOB regards firm and network-wide quality controls as untrustworthy, and believes that lead auditors should trust no-one unless they have no choice, and that they should seek to perform the work themselves wherever possible. This approach seem to ignore, a number of structural issues that standard-setting cannot address. We urge the PCAOB to take a more nuanced and intelligent approach to these difficult issues. Investments made by network firms to improve common standards should enable lead auditors to make some use of the overall systems of quality control within such networks.

The development and application of quality control standards, both within firms and across networks, driven to a great extent by audit regulators, has been critical in enhancing audit quality the last fifteen years. Lead auditor work on the quality control standards of other auditors is key to the approach to many if not most large group audits. We do not question the need for improvement in the application of those standards, but we are perplexed by these proposals because while they acknowledge the importance of quality controls, they appear to dismiss their value almost entirely by effectively, if not explicitly, encouraging auditors to bypass auditors who co-ordinate other auditors by requiring direct communicating with lower tier auditors

26. At the very least, the standard itself should contain the PCAOB’s note to the effect that lead auditors may be able to access more readily information about network affiliates than non-affiliated firms.

Q4: Are the proposed amendments relating to the knowledge, skill, and ability of the other auditor, revised by this release, appropriate? Are there any practical challenges associated with the revised amendments? If so, what are they, and how could the proposed requirements be modified to address the challenges?

27. We agree that merely obtaining a statement from a network firm that it complies with network-wide qualification requirements for staff assigned to PCAOB audits would be inadequate and that it is important for lead auditors to understand situations in which other auditors had been required to make improvements as a result of local regulatory inspections, for example. In practice, gaining an understanding of the knowledge, skill and ability of individuals who assist in planning or supervision is commonplace as are inquiries regarding other auditor policies and procedures related to training of staff working on PCAOB audits and their assignment thereto. However, this can and should be dealt with through the summary memorandum rather than as a separate exercise and we note in our main points above that summary memoranda are in practice ‘cascaded up’ through reporting hierarchies and that requiring lead auditors to obtain individual memoranda from other auditors will be performed as a compliance exercise only.

Q5: Are the proposed new addition to AS 1015 and revision to AS 1201 relating to the other auditors' responsibility appropriate and clear? Is it clear that AS 1015 already applies to referred-to auditors that perform audits under PCAOB standards?

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Q6: Are the proposed new additions to AS 2101.B2 appropriate and clear? Also, is it clear that the necessary level of detail of the other auditor's audit documentation that the lead auditor obtains and the necessary extent of the lead auditor's review according to requirements in proposed Appendix B of AS 1201 are scalable based on the factors in the existing standard regarding the necessary extent of supervision?

28. We refer to our answer to Q2, above.

29. We agree with two new notes clarifying that the level of detail in the other auditor's documentation reviewed should be determined with reference to the necessary extent of supervision. While we agree that in general, review should amount to more than discussions, it would be helpful for the standard itself to note that, as the PCAOB itself acknowledges, technology can be used to review documentation. This is often an efficient supplement or in some cases alternative to visiting the other auditors.

30. Documentation of visits to other auditors is important in terms of the purpose of the visit, what inquiries and other work are planned, what is actually performed, the extent to which that work is sufficient to achieve the objectives of the visit, necessary follow-up work and conclusions.

31. We also re-iterate the following point made in our response to the 2016 proposals:

Auditors note that the first question regulators often ask are about visits to group companies and other auditors. Visits to other auditors or the entities they audit can be wasted if the purpose of the visit is not clearly thought out, the visit is poorly managed, if it is too short, undertaken for the sake of appearances, and if those sent are poorly briefed or are insufficiently experienced to deal with unprepared or hostile hosts. But such visits are often performed in the belief that regulators are less likely to question such an approach, than they are a decision to review files, which is too often interpreted as a cost management exercise.

Q7: Are the revised proposed requirements for situations in which the lead auditor directs another auditor to perform supervisory procedures with respect to a second other auditor on behalf of the lead auditor clear? If not, how should the revised proposed requirements be revised?

32. In the context of multi-tiered audits the PCAOB acknowledges concerns regarding the bypassing of first other auditors and requiring lead auditors to communicate directly with second other auditors. In our response to the 2016 proposals, we argued forcefully, as the PCAOB acknowledges, that first other auditors are often better positioned to make those communications because they understand local operations and controls better than the lead auditor. We are therefore pleased that the PCAOB is proposing to permit a first other auditor to make certain communications to a second other auditor in a multi-tiered audit, as long as the lead auditor receives adequate information about the communications and retains a copy thereof, including the second other auditors' summary memorandum. The work of the first other auditor in relation to the second other auditor should mirror the work of the lead auditor in relation to the first other auditor.

33. All of that said, while the revised proposed requirements are clear, we do not believe that they go far enough. There is still scope for better use of first other auditors in multi-tiered audits without compromising audit quality. The revised proposed requirement for lead auditors to obtain, review and retain a summary memorandum from second other auditors through the first other auditor, rather than directly from the second other auditor is a step forward but it is still far from reflective of the manner in which companies and their auditors actually operate.

34. We fully acknowledge the need for lead auditors to engage with second other auditors directly without reference to first other auditors. In any business, those with high level responsibilities

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must attend to the reports of those they appoint to manage business activities but from time to time they must also ‘walk the floor’, to understand what is actually happening and to encourage diligence in reporting. But if the need to verify is paramount and the controls designed to form a basis for trust are never tested, such controls become redundant. There is little point in appointing a layer of middle management if senior management ignores it and continues to manage the business as if it was not there.

35. It is impossible to control everything from the top. The revised requirements would be further improved if they acknowledged more clearly the critical role of the risk assessment that is, in practice, carried out at all levels. The PCAOB should acknowledge properly the ability of first other auditors to effectively supervise and monitor second (and more) other auditors to avoid lead auditors obtaining information of limited value to the audit.
36. Lead auditors will in practice make use of the lines of responsibility and reporting in multi-tiered audits in performing their risk assessments and determining their responses. They will focus on the summary memoranda obtained from first other auditors, which in turn will cover the work of second other auditors. Summary memoranda are in practice ‘cascaded up’ through reporting hierarchies. If the PCAOB also requires lead auditors to obtain, review and retain summary memoranda from second other auditors, they will of course do so, but as a compliance exercise and in a perfunctory manner, because that is what the PCAOB expects, and what PCAOB inspectors will seek to inspect.

Q8: Is the revision to the proposed standard relating to the division of responsibility when the company and its business unit use different reporting frameworks appropriate and clear?

37. We note in our main points above our belief that a better way of dealing with divided responsibility would be to adopt the approach taken under the ISAs and in advanced jurisdictions elsewhere in the world, by requiring the same work effort for lead auditors in all situations, regardless of whether responsibility is divided. While it may sometimes be difficult for lead auditors to supervise the work of other firms, and a specific audit approach may be impracticable in a specific area for a specific entity, it is rarely if ever wholly ‘impracticable’ for lead auditors to supervise other auditors.
38. The approach of regulators is critical in this area, and the SEC applies a high hurdle for analogous impracticability tests and applies judgement as appropriate to specific areas in individual cases. There is no reason why the PCAOB, as a mature regulator, should not do the same.
39. The PCAOB would better serve US investors if it raised the standard for divided responsibility to that required under the ISAs. The PCAOB should not continue to support this differential approach, still less extend it to situations in which different financial reporting frameworks are in use.

Q9: Is it clear how the proposed amendments and new standard (as revised by this release) relate to other amendments to auditing standards proposed or adopted by the Board since the 2016 Proposal?

Q 10: Comment is requested on the matters discussed in this section. Would any revisions the Board is considering for adoption affect the scalability of PCAOB standards in this area? Would any have a significant effect on the competitiveness of smaller audit firms? Would the revisions significantly change the costs and benefits associated with the proposed changes discussed in the 2016 Proposal? Are there any unintended consequences that the Board should consider? Are there any other matters not addressed in this release the Board should consider in its economic analysis?

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40. We note elsewhere in this response our support for:

- the removal of the proposed requirement for lead auditors to record a description of other auditor documentation reviewed but not retained, and of the requirement for certain communications to be made directly between lead auditors and second other auditors, bypassing first other auditors;
- secondees from other accounting firms and employees of shared service centres working under the lead auditor's guidance and control being treated as employees of the lead auditor's firm and not as other auditors;
- the acknowledgement that summary memoranda are widely used in practice and that a good audit trail is important in any audit involving more than one auditor, but that the content of summary memoranda varies extensively depending on circumstances.

41. All of these improvements will be of disproportionate benefit to smaller audits. However, these improvements do not go far enough and the PCAOB can and should permit lead auditors to make much better use of first other auditors in multi-tiered audits, not least because attempts to control everything from the top are likely to fail.

42. In this response, we point out in a number of areas that under the proposed revised requirements, auditors are likely to obtain documentation for inspection and compliance purposes only. That documentation comes at a cost. It is largely irrelevant to the 'real' audit, clutters the audit file and draws attention away from the real risks assessed. This is bad for all audits but it particularly deleterious to smaller audits that have no slack built into them to accommodate such distractions.



CENTER FOR CAPITAL MARKETS
COMPETITIVENESS

TOM QUAADMAN
 EXECUTIVE VICE PRESIDENT

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November 15, 2017

Ms. Phoebe W. Brown
 Secretary
 Public Company Accounting Oversight Board
 1666 K Street, NW
 Washington, DC 20006-2803

Re: PCAOB Supplemental Request for Comment on *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard on Dividing Responsibility for the Audit with Another Accounting Firm* (PCAOB Release No. 2017-005, September 26, 2017) (PCAOB Rulemaking Docket Matter No. 042)

Dear Ms. Brown:

The U. S. Chamber of Commerce (the “Chamber”) created the Center for Capital Markets Competitiveness (“CCMC”) to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy.¹ CCMC believes that businesses must have a strong system of internal controls and recognizes the vital role external audits play in capital formation.

CCMC supports efforts to improve audit effectiveness and appreciates the opportunity to comment on the Public Company Accounting Oversight Board (“PCAOB”) Supplemental Request for Comment on *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard on Dividing Responsibility for the Audit with Another Accounting Firm* (PCAOB Release No. 2017-005, September 26, 2017) (PCAOB Rulemaking Docket Matter No. 042) (the “Supplemental Request”).

¹ The Chamber is the world’s largest federation of businesses and associations, representing the interests of more than three million U.S. businesses and professional organizations of every size and in every economic sector. These members are both users and preparers of financial information.

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The Supplemental Request presents revisions to the PCAOB's April 2016 Proposal. CCMC provided comments on the April 2016 Proposal² and appreciates that the Supplemental Request responds to some of the concerns we raised.

Nonetheless, CCMC continues to have concerns about whether the revisions now being considered by the PCAOB strike the right balance on the responsibilities of the lead auditor. Further, the Supplemental Request lacks any updated discussion of economic impacts – especially a fulsome consideration of the costs to companies and consequences for smaller audit firms. We also discuss other matters, including the PCAOB's proposed approach for determining an effective date for any ultimately adopted and approved standard.

Responsibilities of the Lead Auditor

Our July 2016 letter highlighted that the initial Proposal put the onus on the lead auditor for all aspects related to supervision of other auditors. We emphasized the importance of PCAOB auditing standards appropriately balancing the responsibilities of lead and other auditors to avoid undermining incentives for other auditors to conduct high quality audits.

The Supplemental Request recognizes that our concerns were likewise expressed by a number of others. In response, the Supplemental Request states that the PCAOB plans to add a reminder that other auditors are responsible for conducting audits with due care.³ Unfortunately, any such reminder would not change the proposed requirements for lead auditors or counterbalance the consequences of the amendments proposed in the Supplemental Request.

Thus, CCMC continues to question whether the amendments to auditing standards currently being considered by the PCAOB are properly calibrated with regards to the responsibilities of the lead auditor vis-à-vis other auditors. Similar concerns as to this balance apply to the proposed requirements on multi-tiered audits where the lead auditor directs another auditor to perform supervisory procedures with respect to a second other auditor on behalf of the lead auditor.⁴

² See the July 29, 2016 letter from the U.S. Chamber of Commerce Center for Capital Markets Competitiveness on PCAOB *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Accounting Firm* (April 12, 2016).

³ See the Supplemental Request, pages 18-19.

⁴ See the Supplemental Request, page 23.

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Relatedly, CCMC is concerned about portions of the Supplemental Request that ignore relevant components of audit firm quality control systems and extend the lead auditor's responsibilities to the engagement level (rather than firm level). For example, the Supplemental Request states that the PCAOB is considering placing responsibilities on engagement teams for understanding other auditors' processes for determining compliance with independence and ethics requirements; understanding the knowledge, skills, and ability of other auditors who assist the lead auditor in planning or supervising the audit; and inquiring about other auditors' policies and procedures related to the training of all personnel who work on audits performed under PCAOB standards and the assignment of personnel to PCAOB audits.⁵

Compliance with independence and ethics requirements and the assignment, supervision, and training of personnel are all components of audit firm quality control systems. The PCAOB's standard-setting authority includes quality control standards. Moreover, PCAOB inspections include audit firm quality control systems, as do audit firms' internal inspection processes. Further, affiliated audit firms in global networks are often subject to additional firm requirements in regards to these matters. Engagement teams should be able to look to these audit firm processes and not have to make their own annual assessments of processes, policies, and procedures for independence, ethics, knowledge, skills, ability, training, and supervision on every audit for each and every other auditor – especially in regards to these aspects for network affiliate firms.

Moreover, it is not clear whether or how audit quality would be enhanced with these duplicative efforts by lead auditor engagement teams. Thus, it appears that the Supplemental Request includes proposed amendments to auditing standards that do not advance audit quality, while involving duplicative and unnecessary costs that will likely be passed on to companies via higher audit fees.

Otherwise, the PCAOB has a long-standing initiative to consider revising its quality control standards. According to a September 30, 2017 update from the Office of the Chief Auditor:

The staff is exploring whether there is a need for changes to PCAOB quality control standards – including improvements related to assignment and documentation of firm supervisory responsibilities – that could prompt firms to improve their quality control systems

⁵ See the Supplemental Request, pages 12, 15, and 15, respectively.

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*and more proactively identify and address emerging risks and deficiencies, thereby enhancing audit quality.*⁶

CCMC encourages the PCAOB to focus on revising its quality control standards, rather than adding requirements for lead audit engagement teams to perform work that duplicates that of audit firms' quality control systems.

Economic Impacts

The Supplemental Request has a brief section on economic considerations that includes a paragraph on impacts describing the proposed revisions as “clarifying” and “modest.” Accordingly, the PCAOB omitted any updated economic analysis because: “The Board has preliminarily concluded that the impact of the revisions discussed in this release relative to the 2016 Proposal would be negligible from an economic perspective.”⁷

This conclusion seems inconsistent with the nature of the proposed revisions and the discussion of them in the Supplemental Request. While we appreciate that the Supplemental Request solicits additional information on economic considerations, CCMC strongly believes in the importance of the PCAOB doing an updated and robust analysis of economic considerations for any proposed amendments.

For example, as previously noted, it appears the proposed requirements will have a significant impact on companies and smaller audit firms. The PCAOB needs to consider these impacts. Further, in regards to smaller audit firms, the following language in the Supplemental Request appears to be anti-competitive:

*If some smaller firms decide to discontinue performing audits involving other auditors, the Board expects that most, if not all, of those firms are likely to continue to conduct audits in other segments of the market, including private company audits, and issuer audits that do not involve other auditors.*⁸

It seems problematic that the PCAOB would view it as appropriate to craft new requirements on the supervision of other auditors that would drive smaller audit firms out of the market for public company audits – especially given the PCAOB's inspection and enforcement processes available to address deficient audits.

⁶ See PCAOB Standard-Setting Update – Office of the Chief Auditor (September 30, 2017), pages 5-6.

⁷ See the Supplemental Request, page 42.

⁸ See the Supplemental Request, page 42.

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Other Matters

CCMC would also like to comment on a few other aspects of the Supplemental Request related to documentation, effective date, and dividing responsibility.

As to documentation, the Supplemental Request states that the PCAOB is considering a requirement for lead auditors to obtain a summary memorandum from each other auditor. The summary memorandum would include a description of the other auditor's procedures, findings, conclusions, and, if applicable, opinion, in sufficient detail for the necessary level of supervision.⁹

While the PCAOB considers this requirement generally consistent with existing auditing practice,¹⁰ CCMC understands this is not necessarily the case. At a minimum, this suggests there is confusion over what the PCAOB intends for documentation. Thus, the PCAOB should clarify how the proposed supplemental memorandum would be incremental to current practice for engagement completion documents (e.g., summary review memorandum and the like now used by audit firms).

As to effective date, the Supplemental Request states:

The Board is considering whether compliance with an adopted standard and amendments should be required for audits of fiscal years beginning in the year 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).¹¹

CCMC strongly recommends an effective date for (all) audits of fiscal years beginning in the year at least two years after the year of approval by the Securities and Exchange Commission ("SEC"). The proposed amendments involve aspects of the "block and tackling" work of auditing and have global considerations. Audit firms need adequate time to implement new requirements on a global basis.

Lastly, on dividing responsibility, we appreciate that the PCAOB is proposing incorporating a threshold analogous to a quantitative one that appears in staff guidance set forth in the Financial Reporting Manual of the SEC. CCMC also appreciates that, consistent with current practice, the PCAOB recognizes this would

⁹ See the Supplemental Request, page 19.

¹⁰ See the Supplemental Request, page 19.

¹¹ See the Supplemental Request, page 44.

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not be a bright-line test, but would create a presumption which could be overcome in some circumstances.¹²

While we support a proposed amendment that incorporates existing requirements, it also provides an opportunity to recognize the importance of post-implementation review to ensure that existing SEC requirements are not altered by incorporating them in PCAOB auditing standards. More generally, post-implementation review of new requirements for the supervision of other auditors would help mitigate any other unintended consequences from *de facto* standard-setting through the inspection process.

Thank you for your consideration of these comments and we stand ready to discuss them with you further.

Sincerely,

A handwritten signature in black ink, appearing to read 'TK' followed by a long horizontal flourish.

Thomas Quadman

¹² See the Supplemental Request, page 10.



Exhibit 2(a)(D)

Alphabetical List of Commenters on the Proposal in PCAOB Release No. 2021-005
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1	BDO USA, LLP
2	Center for Audit Quality
3	CFA Institute
4	CohnReznick LLP
5	Robert A. Conway
6	Council of Institutional Investors
7	Crowe Horwath LLP
8	Deloitte & Touche LLP
9	Ernst & Young LLP
10	Grant Thornton LLP
11	ICAEW
12	Illinois CPA Society
13	KPMG LLP
14	Mazars USA LLP
15	National Association of State Boards of Accountancy (NASBA)
16	PricewaterhouseCoopers LLP
17	RSM US LLP
18	Thomas H. Spitters,
19	Texas Society of Certified Public Accountants



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330 North Wabash, Suite 3200
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November 30, 2021

Via E-mail: comments@pcaobus.org

Office of the Secretary
 Public Company Accounting Oversight Board
 1666 K Street, NW
 Washington, DC 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 042

Dear Office of the Secretary:

BDO USA, LLP (BDO) appreciates the opportunity to comment on the Public Company Accounting Oversight Board's ("PCAOB" or the "Board") 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* included in PCAOB Release No. 2021-005, issued on September 28, 2021 (collectively, the "proposed amendments" or "proposal")¹.

We appreciate the Board's efforts to date in taking account of our views and those of other commenters with respect to the proposed amendments to its auditing standards on this important topic. Consistent with the views expressed in our previous comment letters to the proposed amendments in this area in 2016 and 2017, we remain highly supportive of the Board's overall objectives of improving audit quality by strengthening the existing requirements relating to the lead auditor's involvement in the work of other auditors in a manner that is both risk-based and scalable to audits of issuers of different sizes and complexities.

Our comments focus on the following areas of the proposal that, in our opinion, would benefit from further clarifications, scalability considerations, and emphasis on exercising professional skepticism and professional judgment.

- 1) Definition of the term "secondee" (Refer to our comments to Question 3)
- 2) Lead auditor determination (Refer to our comments to Question 4)
- 3) Supervision of other auditors (Refer to our comments to Question 7)
 - Nature and extent supervision and review activities by the lead auditor.

¹ Including certain amendments first introduced in the *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 (April 12, 2016); and subsequently amended in the *Supplemental Request for Comment: Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard—Dividing Responsibility for the Audit with Another Accounting Firm*, PCAOB Release No. 2017-005 (September 26, 2017).



- Lead auditor's approach to obtaining, reviewing, and retaining documentation.
- Emphasis on effective two-way communication between the lead auditor and the other auditor.

Alignment with the International Auditing and Assurance Standards Board (IAASB)

The Board's objectives with respect to this proposal are consistent with the objectives of other standard setters, including the IAASB. The IAASB has an active project associated with revising its auditing standard that is relevant to multi-location engagements that involve other auditors, ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*. The IAASB issued an exposure draft of the proposed revisions to ISA 600 with an invitation for public comment on April 27, 2020 that was due by October 2, 2020. Based on our understanding of the status of this project, an enhanced version of ISA 600 (Revised) that takes account of the public comments received is expected to be approved by the IAASB in December 2021, and a final revised standard is expected to be issued in the first half of 2022 upon approval by the Public Interest Oversight Board (PIOB).

We ask that the Board carefully monitor the IAASB's progress and proposed revisions to ISA 600 in comparison to its proposal to achieve directional alignment and avoid unnecessary differences. Significant differences between the two standards may create additional challenges in implementing the standards, particularly within firms that are part of a global network that rely on common methodologies, technologies, tools, training, and quality assurance monitoring. Such factors play an important role in supporting the effectiveness of the communication and coordination of audit work between the lead auditor and other auditors that are affiliated with the same network.

Overall Changes

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

In recent years, the rapid pace of growth in emerging technologies has contributed, in varying degrees, to evolving: (i) organizational structures; (ii) business models, including the creation of new business models; (iii) internal business processes; (iv) interactions of employees with each other; and (v) interactions of companies with their customers.



For example, the use of cloud computing has contributed to an increasingly agile and distributed workforce that is capable of working from any location, thereby blurring the lines between an individual's physical and online presence, particularly in hybrid and remote work environments. Cloud-based enterprise systems and platforms, including collaboration and productivity tools, have played a significant role in supporting companies establishing remote and hybrid work environments. Cloud-based solutions have enabled companies to eliminate geographical barriers that otherwise posed challenges for employees in different physical locations from remotely accessing shared information and collaborating with each other on a real-time basis. Such technology solutions have contributed to the growth in geographically dispersed operations, providing companies with access to a wider and more diverse workforce, increasing cross-border investments in geographic locations with lower cost structures, and reducing the time and costs associated with business travel.

Cloud-based solutions have facilitated enhancements in auditor practices related to the use of other auditors, specifically with respect to the manner in which: (i) lead auditors and other auditors communicate and coordinate activities relating to the audit; and (ii) lead auditors supervise and review the other auditor's work remotely, when not prohibited by laws or regulations. Similarly, cloud-based solutions have enabled auditors to improve the manner in which they coordinate and communicate with clients on matters relating to the audit, including managing audit requests relating to source documents and other information prepared by the client. Further, the lead auditor's ability to remotely access such information prepared by the client at the business unit level, when not prohibited by laws or regulations, further supports the lead auditors' supervisory responsibilities.

Other examples of emerging technologies affecting the operations of many issuers include increased investments and use of data analytics, Internet of Things (IoT), artificial intelligence / machine learning, blockchain, and robotic process automation. The increasing use of such emerging technologies has enabled companies to gather and evaluate large amounts of data relating to its operations, automate processes, and monitor and source predictive analytics that support faster and more informed business decisions.

In light of the evolving use of technology in this manner, we ask that the Board reconsider the ongoing relevance of a professional's physical location with respect to its definition of a 'secondee'. Refer to our comments to Question 3 for further details.

Definitions

- **Question 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?

In light of the increasing use of hybrid and remote working environments and the emerging use of technology that is described in our comments to Questions 1 and 2, we ask the Board to reconsider its definition of “secondee” included in the footnote to the proposed definition of “lead auditor” in paragraph .A4 of AS 2101. Specifically, footnote 5 describes a secondee as 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)”.

While secondment arrangements have been traditionally structured to require secondees to physically relocate to a host country firm for a specified period of time, we believe that the physical location of the professional is not particularly important to the substance of such arrangements. In light of the travel restrictions imposed by various jurisdictions in response to the ongoing COVID-19 pandemic, we believe that the application of this definition in the current environment is very challenging.

We suggest the following revision to the definition of “secondee” in footnote 5 to proposed AS 2101.A4 (Additions are presented in **bold** text and deletions in ~~strikethrough~~):

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~~ **works under the direction and control** of the registered public accounting firm issuing the auditor’s report **in another country and functions as that firm’s employee** 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”).

Additionally, we recognize that the definition of a secondee in the proposed amendments may have been adopted from the PCAOB’s Staff Guidance - Form AP, *Auditor Reporting of Certain Audit Participants and Related Voluntary Audit Report Disclosure Under AS 3101, Reports on Audited Financial Statements* (February 16, 2017). As such, any revisions to the description of a secondee in the proposed amendments to modernize the standards will require conforming amendments to the above Staff Guidance.



Lead Auditor Determination

- **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?**

We find the three considerations listed in proposed AS 2101.6A to be reasonable; however, we find the proposed requirements, as written, to be incomplete with respect to the considerations presented and prevents further consideration of other relevant factors that may collectively inform an auditor's professional judgement in determining whether it is appropriate to serve as the lead auditor.

In our experience, determining which firm is in the best position to serve as the lead auditor is often much more complex and involves consideration of various other facts and circumstances that are relevant to both: (a) the company; and (b) the auditor, particularly with respect to determining how the audit will be conducted, and whether the auditor is able to appropriately direct and supervise the work of other auditors effectively.

- For example, factors relating to the company that may inform the auditor's professional judgment include:
 - (i) where the company is domiciled in the U.S. or outside the U.S., and the geographic locations or jurisdictions in which the company operates;
 - (ii) the geographic location of members of the audit committee, key decision makers of the company, including those in financial reporting oversight roles; and
 - (iii) whether the company uses centralized accounting functions such as shared service centers to process transactions on behalf of several business units of the company.
- For example, factors relating to the audit that may inform the auditor's professional judgement include:
 - (i) whether the engagement team has direct access and ability to effectively communicate with the audit committee and the key decision makers of the company, including those in financial reporting oversight roles based on the geographic location of such individuals and consideration of potential differences in language, time zones, or cultures;
 - (ii) the engagement team's knowledge and experience working with the other auditor, including whether the other auditor is part of the same network as the lead auditor; and



- (iii) legal restrictions imposed by certain jurisdictions in providing foreign access to the company's financial information and other auditors' work papers.

We suggest that the Board clarify the requirements in proposed AS 2101.6A to enable the engagement partner to consider any other facts and circumstances that are relevant to the lead auditor's determination in addition to the three considerations currently listed in the proposal.

We suggest the following revision to proposed AS 2101.06A (Additions are presented in **bold** text and deletions in ~~strikethrough~~):

In making this determination, the engagement partner should take into account the following, as well as other relevant factors specific to the audit in combination:

Supervision of Other Auditors

- **Question 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?**

We are highly supportive of the Board's objectives of enhancing the lead auditor's oversight of other auditors in a manner that is risk-based and scalable; however, we find the proposed amendments in paragraphs .07-.13 of AS 1201 do not achieve the flexibility necessary in the lead auditor's approach to obtaining, reviewing, and retaining documentation under a wide range of circumstances that exist in practice. For example:

- 1) The nature and extent of audit documentation required to be retained by the lead auditor to demonstrate its supervision and review of the other auditor's work in accordance with paragraphs .09 - .12 do not appear to be adequately scalable.

For example, the lead auditor and the other auditor may be part of the same network of firms. Additionally, the lead auditor may have access to the other auditor's work papers during the audit to facilitate its ongoing supervision and review responsibilities. In such situations, the lead auditor is able to directly review the audit procedures to be performed pursuant to the scope of work assigned to the other auditor to comply with the requirements in paragraph .09. In practice, the lead auditor's communication with respect to necessary changes to the other auditor's planned procedures may be iterative and fluid in nature, and achievable through more effective means than a formal written



communication. The lead auditor can confirm that such changes have been made based on its access and review of the other auditor's workpapers. In such situations, we believe that the proposed requirements in paragraphs .09 and .10 establish unnecessary and incremental document retention requirements on the lead auditor.

- 2) The proposed amendments do not adequately acknowledge the importance of the other auditor's role in the audit. In certain situations, the other auditor may have a more in-depth knowledge of the business unit, and the foreign jurisdiction in which it operates. In such situations, the scope of work to be performed by the other auditor may include:
 - a) designing and performing risk assessment procedures on the financial information of the business unit or on one or more specific accounts; and
 - b) determining the nature, timing, and extent of audit procedures to be performed in response to the assessed risks of material misstatement of the financial information of the business unit and the consolidated financial statements.

In such instances, effective two-way communication between the lead auditor and the other auditor is particularly important, and facilitates the lead auditor's direction, supervision, and review of the other auditor's work.

Effective Date

Based on the nature and scope of the proposed amendments and new auditing standard, we recommend that the proposed amendments should be effective for audits of fiscal years beginning no earlier than two years after approval by the SEC (or for audits of fiscal years beginning three years after the year of SEC approval if that approval occurs in the third or fourth calendar quarter).

The effective date and implementation period will provide firms with the time needed to implement these changes to firm policies and guidance, develop and deliver necessary learning, coordinate alignment of quality control processes across firm networks, and communicate the changes in advance of the effective date.

On pages 66 and 67 of the Release, it states that "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 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)." In our opinion, the effective date considered in this section would not provide adequate time needed to effectively implement the changes in the proposal.

* * * * *



We appreciate the opportunity to comment on the Second Supplemental Request for Comment and would be pleased to discuss our comments or answer any questions that the PCAOB staff or the Board may have regarding the views expressed in this letter. Please direct any questions to Patricia Bottomly at 310-557-8538 (pbottomly@bdo.com) or Ashwin Chandran at 214-689-5667 (achandran@bdo.com).

Sincerely,

BDO USA, LLP

BDO USA, LLP

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November 30, 2021

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

Re: PCAOB Release No. 2021-005, Rulemaking Docket Matter No. 042:
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

Dear Office of the Secretary:

The Center for Audit Quality (CAQ) is a nonpartisan public policy organization serving as the voice of U.S. public company auditors and matters related to the audits of public companies. The CAQ promotes high-quality performance by U.S. public company auditors; convenes capital market stakeholders to advance the discussion of critical issues affecting audit quality, U.S. public company reporting, and investor trust in the capital markets; and using independent research and analyses, champions policies and standards that bolster and support the effectiveness and responsiveness of U.S. public company auditors and audits to dynamic market conditions.

The CAQ appreciates the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or the Board) [Release No. 2021-005: 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](#) (individually the proposed amendments and proposed standard, respectively, and collectively, the Second Supplemental Request for Comment or Release).

As we have previously expressed, the CAQ shares the PCAOB's goal of improving audit quality and supports the PCAOB's continued consideration of revisions to auditing standards guiding the supervision of other auditors.¹ In the time since the Board's initial proposal and first supplemental request for comment were issued,² there have been considerable changes in the ways public companies prepare and auditors audit financial information. Specifically, the technology available to share data and work remotely has significantly evolved as public companies and their auditors become increasingly more global. This was accelerated due to the pressing need to operate in a remote or

¹ See the CAQ's [initial](#) and [second](#) comment letters on this topic dated July 29, 2016 and November 15, 2017, respectively.

² The Board issued [Release No. 2016-002: Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Audit Firm](#) (the Initial Release) on April 12, 2016 and [Release No. 2017-005: 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](#) (the First Supplemental Request for Comment) on September 26, 2017.



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hybrid environment as a result of the COVID-19 pandemic. Interactions between public companies and their auditors, as well as lead auditors and other auditors or referred-to auditors are less dependent on physical location allowing for increased flexibility and effectiveness.

Technology is being used to effectively support the direction and supervision of other auditors and facilitate the timely review of their work in a remote environment. The need to provide clarity for the relationships between lead auditors and other auditors as part of this important standard setting project has become increasingly relevant in light of these worldwide developments. We do not believe these developments have been fully taken into account in the Release and further revisions are needed to ensure the final amendments and final standard appropriately recognize these developments, including providing clarity for how the requirements can be met when considering the circumstances that exist today and practical changes that will arise in the future.

We appreciate the careful consideration the Board has given to comment letters received in connection with both the initial proposal and the first supplemental request for comment. We acknowledge that certain changes proposed by the PCAOB appear to be moving toward a more practical way to achieve the Board's desired outcome to improve audit quality. In this letter, we offer for the Board's consideration our views regarding certain items in the Second Supplemental Request for Comment.

Overall Changes

- Q1 – *In recent years, have there been changes to auditor practices related to the use of other auditors?*
- Q2 – *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?*

In recent years, there have been a number of changes in auditor practice as it relates to the use of other auditors, as well as changes to issuer circumstances that affect how audits of multinational or other companies are conducted with regard to work performed by other auditors.

A significant change is the auditor's ability to work effectively in a largely remote environment. The ways companies prepare financial information and auditors audit that information has evolved considerably both out of necessity and through technological advances. We expect this practice to continue with the rise in popularity and effectiveness of the hybrid work model. This has dramatically changed 1) the physical locations from which both finance professionals and auditors work, 2) the ways these individuals interact with each other (e.g., video conference versus meeting in-person), and 3) the ways in which information is exchanged in connection with the preparation of financial information and the execution of the audit, including increased leverage of technology and virtual tools.

While the pandemic accelerated the remote work and virtual environment trends, the audit has been evolving gradually in this direction for many years, which enabled the quick transition that occurred in 2020. Even before the pandemic, financial reporting systems and audit evidence available were increasingly becoming electronic. Audit workpapers have long been electronic at many firms and often may be accessible by reviewers remotely, although law or regulation in particular jurisdictions may impact the manner and extent of their accessibility.

The proposed amendments and proposed standard focus on the relevance of both the physical location of individuals performing work related to an audit, and the ways that information should be exchanged between parties within an audit, often in writing. In our view, these proposals do not clearly contemplate recent changes in the financial reporting ecosystem. We refer to a few issues that stem from this concept in responses to the questions below.



We also believe that it is critically important that the Board consider developments regarding the modernization of other auditing standards that have been approved since the initial proposal was issued or are expected to be approved in the near future. For example, many stakeholders recognize that International Standard on Auditing (ISA) 600 is an important standard in improving the quality of multi-location audits. The Exposure Draft of proposed ISA 600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* (ED-600),³ approved for exposure in March 2020, is a substantive revision of ISA 600. We expect ISA 600 (Revised) will be approved before the end of 2021. It will be difficult for auditors to implement the PCAOB's proposed amendments and proposed standard if they were to compete, or be incompatible, with features of ISA 600 (Revised). We encourage the Board to take this and any other recent, relevant auditing or professional standards into account to minimize differences with the proposed amendments and proposed standard.

Definitions

- Q3 – *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?*

Given the flexibility in location from which audit professionals may execute their work, as demonstrated throughout the COVID-19 pandemic, we have concerns that the definition of “seconded” included as a footnote within the definition of lead auditor in the Release is overly prescriptive.

Footnote 5 of AS 2101.A4 refers to the definition of a seconded as, “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)” (emphasis added).

In practice, there are increasingly more circumstances whereby audit firms use secondees, who are directed and supervised by the lead auditor, without requiring them to relocate from the country where the seconded’s accounting firm is domiciled. In such circumstances, the seconded is treated no differently than employees from the lead auditor’s firm who are working remotely within its country of domicile. We believe this footnote contradicts the diversity of ways in which the auditing profession has evolved seconded staffing models. Thus, this proposed definition of secondees could be challenging to apply in practice as it focuses on form over substance. A remote seconded works under the direction and supervision of the lead auditor in fact and in appearance other than physical location. We strongly encourage the Board to consider this circumstance in the ‘seconded’ definition.

The following is a suggested revision to proposed footnote 5 to AS 2101.A4:

For this purpose, the term “seconded” refers to a professional employee of an accounting firm in one country who is physically located in another country, in the offices works under the direction and control of the registered public accounting firm issuing the auditor’s report in another country, and functions as that firm’s employee 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).

³ See [ED-600](#).



We acknowledge that a 'secondment arrangement' is defined within the PCAOB's *Staff Guidance – Form AP, Auditor Reporting of Certain Audit Participants and Related Voluntary Audit Report Disclosure Under AS 3101, Reports on Audited Financial Statements*, issued on February 16, 2017 (Staff Guidance on Form AP). As such, the impact of any changes made to the definition of 'seconded' within the proposed amendments should be considered within Staff Guidance on Form AP and any other relevant locations.

Lead Auditor Determination

- Q4 – *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?*

We agree with the intent of the Release to increase the likelihood that the firm issuing the auditor's report performs audit procedures for a meaningful portion of the company under audit's financial statements.⁴ We are generally supportive of the modifications made to the proposed amendments regarding the determination of the lead auditor because they better accommodate circumstances in which companies may have significantly dispersed operations. The addition of the third criterion for such determination, the extent of supervision, is useful in bringing a qualitative balance to the determination of the lead auditor. However, we find that the proposed amendments are still too prescriptive such that firms may be challenged to make this determination on the three listed factors alone. Determining the lead auditor involves significant professional judgment, considering both quantitative and qualitative factors. While the proposed amendments provide for three criteria in making this determination, they do not comprise a complete set of factors to be considered for purposes of making such determination, and it is not clear whether certain audit-specific factors may be considered implicitly within the three stated criteria. Additionally, the lead auditor often may not be able to fully consider certain criteria in an audit with divided responsibility, such as the identified risks of material misstatement related to the location or business unit audited by a referred-to auditor.

There is significant diversity in issuer financial reporting structures and the operation of audits involving other auditors. Therefore, auditors need to consider the facts and circumstances applicable to the audit engagement, including, but not limited to, legal restrictions in certain jurisdictions, the legal domicile of the issuer under audit, the location(s) of its books and records, and the location(s) of its executives and key decision makers. There are also factors related to the auditor and audit engagement that should be considered (e.g., professional licensing requirements, the lead auditor's knowledge of, and experience with, the other auditor, and the business environment and culture in which the other auditor operates). Given the level and types of judgment required in making this determination, we encourage the Board to allow for the ability to consider additional relevant factors in proposed AS 2101.06A. This could be done in a manner similar to AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, when critical audit matters (CAMs) were introduced. In part, AS 3101.12 states, "the auditor should take into account, alone or in combination, the following factors, as well as other factors specific to the audit," and then it references six specific factors for consideration in the determination of CAMs. Applying this principles-based approach to AS 2101.06A would provide additional factors for consideration when applying judgment related to the three listed criteria. We believe it would be appropriate for the proposed amendments to allow other relevant factors to be considered based on the facts and circumstances at both the issuer and audit firm levels.

Providing audit firms with the ability to consider other relevant factors, in addition to those included in the proposed amendments, would allow for the application of professional judgment when it is unclear how the three stated criteria should be interpreted, or if certain audit-specific factors may be implicitly

⁴ Page 16 of the Second Supplemental Request for Comment.



considered within those criteria. Other factors should be considered in making the lead auditor determination in combination with the three stated criteria in the proposed amendments. Thus, we encourage the Board to consider modifying AS 2101.06A to provide for a more principles-based approach.

We suggest the following revision to proposed AS 2101.06A:

In making this determination, the engagement partner should take into account the following, as well as other relevant factors specific to the audit in combination:

Supervision of Other Auditors

- Q7 – *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?*

We agree with the purpose of the proposed amendments 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. It is important that the lead auditor takes responsibility for the overall audit process through appropriate supervision of other auditors involved in the audit. However, we have concerns that the proposed amendments included within AS 1201.08-.12 are overly prescriptive. More specifically, we encourage the Board to consider modifying the proposed amendments regarding 1) the determination of the extent of documentation from the other auditor to be reviewed by the lead auditor, 2) the ways in which risks of material misstatement and responses to such risks are communicated between the lead auditor and the other auditor, and 3) input received from the other auditor regarding risks of material misstatement and responses to such risks.

Extent of documentation from other auditor to be reviewed by the lead auditor

In our view, the proposed amendments do not provide a clear framework to enable a lead auditor to determine the necessary extent of documentation from the other auditor to be reviewed by the lead auditor. Doing so is important because, in our view, it directly affects what documentation may be reviewed by the lead auditor.

Paragraph 12 of proposed AS 1201 indicates that the minimum requirement regarding the extent of documentation from the other auditor to be reviewed by the lead auditor is described in paragraph 19 of AS 1215, *Audit Documentation*, and suggests that the lead auditor may direct the other auditor to provide additional specified documentation. We believe that the proposed amendments should clarify that the level of incremental information that may be reviewed by the lead auditor when the minimum is insufficient is based on the facts and circumstances of an audit engagement. There is a spectrum of documentation that could be reviewed by the lead auditor that would be determined by the level of work being performed or risks being addressed by the other auditor, among other factors. For example, the lead auditor may determine that it is only necessary to review the minimum required documentation per AS 1215.19 from the other auditor who is performing very limited work relative to the totality of audit procedures being performed in connection with the audit of the consolidated financial statements. Similarly, the lead auditor could determine that it is necessary to review more documentation from the other auditor who it has assessed to have a lower level of knowledge, skill, and/or ability.

Given this, it would be beneficial for the proposed amendments to acknowledge that the determination of the extent of documentation from the other auditor to be reviewed by the lead auditor should take into account 1) the nature of the location or business unit at which the other auditor will perform audit procedures, 2) the nature, timing, and extent of procedures to be performed by the other auditor, and 3)



the knowledge, skill, and ability of the other auditor evaluated in accordance with AS 1201.06D. We believe this will provide the lead auditor with a clearer basis for making judgments regarding the extent of its supervision of the other auditor.

We highlight that these changes are particularly necessary in light of the way communications with, and supervision of, other auditors occurs when the other auditor's firm is part of the same network of firms. The proposed amendments do not appear to acknowledge that the level of effort in complying with many of the requirements can be based upon whether the firms have a common methodology, training, and monitoring process. In such circumstances, effective network-level processes and controls are an important input to audit quality and should be considered. On the other hand, when the other auditor is not from the same network, different approaches may be acceptable, and there may be limitations on what information can reasonably be obtained in relation to their firms' system of quality control, which might suggest increased involvement is necessary.

Communication of risks of material misstatement and responses to those risks

Regarding the identification and communication of risks of material misstatement and the responses designed to address those risks, the requirements under the proposed amendments state that the lead auditor should:

- inform the other auditor in writing of the identified risks of material misstatement to the consolidated financial statements that are applicable to the location or business unit (AS 1201.08b(1)),
- obtain and review a written description of the audit procedures to be performed pursuant to the scope of work described in AS 1201.08a (AS 1201.09), and
- discuss and communicate, in writing, any subsequent changes to the planned audit procedures to the other auditor (AS 1201.10).

We are concerned that requiring that all such communications be made in writing is overly burdensome and often may not be necessary (e.g., if the lead auditor and other auditor are part of the same network performing procedures using a common methodology). As noted on page 33 of the Release, the 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 auditor and other auditors.

These proposed requirements do not appear to acknowledge the ways in which the lead auditor and the other auditor often communicate in practice, which are ongoing and iterative in nature. Similarly, the proposed amendments do not appear to consider changes to mechanisms of communication employed by lead auditors and other auditors. These have improved significantly in recent years, particularly in light of technological advances in communication tools demonstrated by the successful shift to a hybrid work environment. Such advancements have demonstrated that the lead auditor and the other auditor can communicate effectively in real-time regarding risks of material misstatement and responses to those risks telephonically or via video meetings. Effective two-way communication like this between the lead auditor and the other auditor helps to set expectations for the other auditor and promotes the lead auditor's direction and supervision of the other auditor, which is the intention of the proposed amendments.

Given the iterative nature of the risk assessment process, these parties may agree on changes to the audit plan at various points throughout the audit. This may be executed through a conference call or video meeting. As written, the proposed amendments appear to require that any risks of material misstatement relative to the work to be performed by the other auditor, designed responses to those risks, or changes to those risks or designed responses resulting from that discussion would need to be re-communicated between the lead auditor and the other auditor, *in writing*, even if those topics were discussed and understood by and between each party via a conference call or video meeting. Thus, the requirements



within the Release may inadvertently create an added administrative and cost burden to re-communicate these discussions without an incremental benefit to overall audit quality.

We agree that the initial risk assessment relative to the work to be performed by the other auditor should be communicated, in writing, by the lead auditor to the other auditor and that the initial written description of the audit procedures to be performed by the other auditor and documentation required by AS 1215.19 should be communicated, in writing, by the other auditor to the lead auditor. However, we do not believe that every iteration of the risk assessment or changes to the design of audit procedures to be performed should be written and delivered between the lead auditor and the other auditor in every circumstance if they are communicated clearly through another appropriate means (e.g., conference call, video meeting, or other similar mechanism). We ask the Board to consider clarifying the proposed amendments such that the written communication of subsequent iterations of risk assessment relative to the other auditor's scope of work and changes to the design of audit procedures to be performed by the other auditor are not required in every circumstance, and that the lead auditor can apply judgement in determining if such written communications should be made in writing depending upon its determination of extent of supervision of the other auditor.

Input from other auditors regarding risks of material misstatement

The proposed amendments are also not sufficiently clear regarding the ability of the other auditor to provide input to the risk assessment process throughout the engagement. We acknowledge that page 32 of the Release states that, "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." However, this is not, but should be, clearly stated within the text of the proposed amendments. There are many circumstances in which the other auditor may be better suited to bring identified risks of material misstatements to the attention of the lead auditor throughout the iterative risk assessment process, such as when the other auditor is performing a full scope audit of a business unit within the entity under audit. The other auditor may highlight certain risks of material misstatement to the lead auditor which may be relevant to the consolidated financial statements. While the Release suggests that it may be the intent of the proposed amendments to permit the other auditor to provide input regarding the determination of risks of material misstatement, it is not clear that such discussions, which are iterative throughout the audit, could include feedback provided by other auditors.

We recommend modifying the proposed amendments such that it is clear the other auditor can be an active participant in the determination of risks of material misstatement related to the other auditor's scope of work, with appropriate oversight by and agreement with the lead auditor.

Effective Date

Consistent with the feedback we provided in our comment letter in response to the first supplemental request for comment, we continue to believe that the preparation for and the implementation of the final amendments and final standard, if they are relatively consistent with what is currently reflected in the Release, will take a considerable amount of time, especially given the global scope and the broad changes to existing practice. Implementation will likely be even more difficult for firms that do not operate in a global network, but who audit issuers that operate in multiple jurisdictions. The amount of time firms need to prepare for the final amendments and final standard also may differ based on resources and staffing availability.

Many of the changes proposed would need to be incorporated into the lead auditor's overall audit plan, and communicated to other auditors; therefore, implementation of the changes at the engagement team level will begin at the planning stage of the audit. Firm methodologies, related tools, and guidance will therefore need to be fully updated prior to the beginning of the audit year in which the final amendments and final standard become effective. Audit firms will also need to develop and implement training and



effective quality control processes and procedures to support and facilitate effective implementation of the final amendments and final standard.

On pages 66 and 67 of the Release, it states that “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 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).” We do not believe this period of time would be sufficient to support a high-quality implementation.

In order for firms to sufficiently prepare, we strongly recommend that the final amendments and final standard be effective for audits of fiscal years beginning no sooner than two years after approval by the SEC (or for audits of fiscal years beginning three years after the year of SEC approval if that approval occurs in the third or fourth calendar quarter).

The CAQ appreciates the opportunity to comment on the Second Supplemental Request for Comment and would be pleased to discuss our comments or answer any questions that the staff or the Board may have regarding the views expressed in this letter. Please address questions to Vanessa Teitelbaum (vteitelbaum@thecaq.org) or Taylor Harris (tharris@thecaq.org).

Sincerely,

A handwritten signature in black ink that reads 'Vanessa J.' with a stylized flourish at the end.

Vanessa Teitelbaum, CPA
Senior Director, Professional Practice
Center for Audit Quality

cc:

PCAOB

Duane M. DesParte, Acting Chairperson
Christina Ho, Board member
Kara M. Stein, Board member
Barbara Vanich, Acting Chief Auditor

SEC

The Honorable Gary Gensler, Chair
Caroline A. Crenshaw, Commissioner
Allison Herren Lee, Commissioner
Hester M. Peirce, Commissioner
Elad L. Roisman, Commissioner
Paul Munter, Acting Chief Accountant
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Via E-Mail

December 3, 2021

Office of the Secretary
Public Company Accounting Oversight Board
100 F Street NE
Washington, DC 20549

Re: PCAOB Rulemaking Docket Matter No. 042: Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard—Dividing Responsibility for the Audit with Another Accounting Firm

Dear Acting Chair DesParte:

The CFA Institute appreciates the opportunity to comment on the Public Company Accounting Oversight Board’s (“Board’s”) [*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*](#) (“Supplemental Release”).

CFA Institute is a global, not-for-profit professional association of more than 178,000 members, as well as 157 member societies around the world. Our members include investment analysts, portfolio managers, advisers and other investment professionals. We have a long history of promoting fair and transparent global capital markets and advocating for strong investor protections. An integral part of our efforts toward meeting those goals is to help ensure that corporate financial reporting and disclosures – and the related independent audits – provided to investors and other end users are reliable and of high quality.

We note that the Board’s Supplemental Release contains additional proposed amendments to the auditing standards that have not appeared in prior Board publications. The Board first proposed changes in 2016, and in 2017, the Board proposed additional amendments. On September 28, 2021, through this Supplemental Release, the Board proposed further changes as a result of its continued review of work performed in the audits involving other auditors and the Board’s engagement with stakeholders and standard setters.

Investors rely heavily on the accuracy, transparency, and reliability of the financial information they receive from public companies in order to allocate capital and make voting decisions. The Securities and Exchange Commission (“SEC” or “Commission”) has long recognized that the importance of timely and accurate financial reporting cannot be overstated. For example, in December 2019, a unanimous Commission publicly stated:

High quality, reliable financial statements form the bedrock of our U.S. capital markets.¹

¹ See SEC Chairman Jay Clayton, SEC Commissioner Robert J. Jackson, Jr., SEC Commissioner Hester M. Peirce, SEC Commissioner Elad L. Roisman, SEC Commissioner Allison Herren Lee, Statement on Appointment of New Chair and Five New Members of the Financial Accounting Foundation Board of Trustees, and Appointment of Next Chair of the Financial Accounting Standards Board (December 19, 2019), available at <https://www.sec.gov/news/public-statement/statement-commission-2019-12-19-fasb-gasb-trustees>.



We welcome the opportunity to provide our perspectives on the additional proposed amendments. We agree with the Board that audit quality related to multi-location audits should be improved. We also note that the improvements to the auditing standards related to audits involving other auditors has appeared on the Board’s standard-setting agenda for more than ten years. Accordingly, we encourage the Board to move forward with its finalization of the amendments in a timely manner. As the Board observes, multiple audit firms are involved in approximately one out of every three issuer audits, with inspection findings of deficiencies that have persisted at an unacceptably high level (30% or higher) for nearly a decade.² Consequently, we strongly support Acting Chair Duane DesParte’s statement³ that “*it is...imperative that the [PCAOB]...finish this important project...*”

Summary of Our Letter

As companies’ global operations have grown, the use and role of other auditors has become more significant and has evolved. Audits that involve multiple auditors in other jurisdictions and audits involving multiple auditors present unique challenges in the planning, supervision, and execution of the audit. We agree with Board Member Jurata’s succinct point⁴: “[T]he use of other auditors is pervasive and sometimes risky, so this is a key area for protecting investors.”

In general, we are supportive of the need to increase audit quality in this area and the Board’s project on multi-location audits and the professional responsibilities of auditors involved in those audits. We agree with a number of the provisions but are concerned that the Board’s approach may be too narrowly anchored to defining terms of art that have operated within the auditing profession for decades. Technology continues to reshape the present-day audit with digital technologies and data analysis becoming mainstays of any audit engagement. Moreover, audit firms embraced a “virtual” audit in response to the global pandemic.

We agree with the Board and previous commenters that the proposed audit standards relating to audits involving other auditors are scalable and should be applicable to the audits of Emerging Growth Companies (EGCs) as well.

We agree with the Board that all auditors participating in an audit must comply with the Audit documentation requirements of [AS 1215, Audit Documentation](#). Moreover, the audit documentation must remain accessible to the lead auditor throughout the mandatory retention period.

In the sections which follow, we set forth our views on the use and definition of terms; the knowledge, skill, and ability of and communication with other auditors; the legacy requirements of Appendix K; and the lead auditor’s responsibility in a tiered audit.

² PCAOB Release No. 2021-005 September 28, 2021, *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*, “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.”

³ Duane M. DesParte, Acting Chair, PCAOB, [Statement on Second Supplemental Request for Comment: Proposed Amendments to Auditing Standards Related to the Supervision of Audits Involving Other Auditors](#).

⁴ Rebekah Goshorn Jurata,, Board Member, PCAOB, [Statement on Second Supplemental Request for Comment: Proposed Amendments to Auditing Standards Related to the Supervision of Audits Involving Other Auditors](#).



Newly Defined Terms

The Supplemental Release proposes new definitions to certain terms and the creation of new terms, including “engagement team,” “lead auditor,” “other auditor,” “referred-to auditor,” and “investee’s auditor.” We are concerned that the proposed definitions, which are fairly prescriptive, may be out of date as soon as the Board adopts a final standard and will increasingly be so as the profession evolves. The terms used by audit firms are not ubiquitous. Nor are the terms commonly used among audit standard setters. (e.g., while the PCAOB uses the term “specialist”, the IAASB uses the term “expert”). Further, while the definitions are overly precise in certain ways, they are vague in other ways. For example, consider the multi-pronged approach for determining whether a “specialist” is or is not a member of the engagement team: For specialists to be considered members of the engagement team, the specialist must (1) be an employee of an audit firm involved in the audit, (2) assist the firm, (2a) obtain evidence or (2b) evaluate evidence. Such evidence is conditioned on the following attributes: “with respect to a relevant assertion of a significant account...” The Supplemental Release does not specify why these modifiers are necessary and appropriate.

The proposed definition of engagement team does not encompass newly developed audit technologies or processes that audit firms have developed or implemented, such as service delivery centers, centers of excellence, or other auditor-engaged specialists that may or may not be subject to the lead auditor’s system of quality control. We do not agree with the Board that at all times (now and in the future) shared service centers will be employees of the lead audit firm.

The term also fails to address the increasing use of digital audit tools. We believe that a definition of engagement team could also encompass any device or process with digital audit capabilities, such as those involving artificial intelligence (AI), rules-based anomaly detection, or complex risk assessments that embed machine learning. Whether samples are determined or selected by individuals or an algorithm operating independently or whether inventory is observed by human eyes or by the eyes of a drone guided by AI, the lead auditor should be responsible for the proper planning, supervision, and execution of the audit regardless of the individuals involved or computers, drones, or other techniques deployed.

In sum, we respectfully request the Board to reconsider its approach to these definitions. Rather than adopt a checklist approach for the definitions or the currently used nomenclature, we suggest that the definitions address the necessary roles and responsibilities regarding the planning, supervision, and execution of an audit engagement. We provide the following example as an alternative way to address the challenges we identified above:

Engagement Team: Individuals, organizations, technology, or independent processes that participate or meaningfully contribute to the planning, supervision, or execution of audit procedures (or review procedures concerning an interim review) related to a registered auditor’s audit or review report (whether issued or not).

Further, the Board’s Supplemental Release provides for a number of exclusions but does not provide the reasoning or any basis for the exclusion of certain firm employees that are involved in the planning, supervision, or execution of the audit, such as the Appendix K reviewer, from the definition. We encourage the Board to consider an inclusive approach when assigning definitions to key terms that withstands the test of time and the continued rapid evolution of the audit profession.



Knowledge, Skill, and Ability of and Communications with Other Auditors

As the Supplemental Release and the persistence of inspection deficiencies confirm, the current “gain an understanding” standard of the lead auditor, which typically occurs through inquiry of and written confirmation from the other sub-auditors is no longer fit-for-purpose. A review of SEC and PCAOB enforcement matters demonstrates that audit failures occur either because the other auditor misrepresents its competency, or the lead auditor fails to adequately understand the other auditor’s knowledge, skill, and ability because it is based on representation rather than observation.

In recognizing the weakness of this inquiry-only model, the Board has proposed a new requirement for the lead auditor to “determine another auditor’s compliance with independence and ethics.” We are very supportive of this new provision and applaud the Board for its proposal. We also note that Board’s [Rule 3526](#), which provides for communications to the audit committee, only requires communication from the lead auditor (the registered accounting firm and its affiliates) to the audit committee. Accordingly, we believe the proposed new requirement – with respect to the lead auditor determining compliance about another auditors’ independence and ethics rather than simply inquiring about it – aligns more consistently the responsibility to make such determination with the communication. While we always embrace more communication between auditors and the audit committee, and Rule 3526 does not require communication about compliance by other auditors of independence and ethics rules, aligning the lead auditors’ responsibility in determining and communicating compliance regarding independence and ethics is more effectively integrates responsibility and communication.

The lead auditor should use all available data and information to affirmatively conclude that the lead auditor’s reliance on the knowledge, skills, and ability of the other auditor(s) is reasonable. All available data and information should include the firm’s cumulative knowledge from all interactions with the other auditor. The lead auditor should only assign tasks where there is a reasonable expectation of proficiency. If information comes to the lead auditor’s attention suggesting any deficiency, the lead auditor should determine whether the deficiency affects the ability to rely on the other auditor. Moreover, if the lead auditor has little or no information available, the lead auditor should consider whether the absence of such data or information is an inherent limitation that prevents an affirmative conclusion that reliance on the other auditor is reasonable.

Of equal importance is the degree of information asymmetry that may exist between auditors. For example, the lead auditor may become aware of potential fraud risk indicators that may not be available to an auditor of a subsidiary located in another jurisdiction. However, the other auditor should be informed of the potential fraud risks since they may be relevant to the quality and sufficiency of the work of the other auditor. The lead auditor should be responsible for reducing information asymmetry among all auditors to enhance overall audit quality and mitigate detection risk to a relatively low level.



We Question the Continued Retention of Legacy SECPS Appendix K

Appendix K was developed before the dissolution of the AICPA's SEC Practice Section (SECPS)⁵ and creation of the PCAOB. Accordingly, the application of Appendix K is limited to the non-US firms that were formerly members of the SECPS, prior to its dissolution. The PCAOB has also created its own regulatory regime, including registration with the PCAOB of all firms that audit SEC issuers and improvements to auditing standards.

Appendix K requirements were created to address the SEC's requirement for foreign private issuers (FPIs) with financial statements prepared using a basis other than US GAAP to be reconciled with US GAAP. The SEC was rightfully concerned of the poor quality of such reconciliations, which was a frequent area of staff comment. In 2007, the SEC eliminated this requirement for FPIs that prepare their financial statements in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). Further, as the profession has evolved, a relatively small percentage of FPIs were audited by non-US firms not affiliated with global networks.

Furthermore, the responsibilities of the reviewers under Appendix K appear nebulous at best. The Supplemental Release states that the Appendix K reviewer is excluded from the definition of engagement team, but there is no justification for this exclusion. Moreover, it appears that a lead auditor may be unable to justify reliance on other auditors that lack the quality control environment and procedures to address and monitor compliance with all applicable US requirements (PCAOB standards, US GAAP as issued by the FASB or IFRS as issued by the IASB, and SEC disclosure rules and regulations). We urge the PCAOB to re-consider how Appendix K is expected to contribute to audit quality in the future, whether Appendix K remains fit-for-purpose, and whether Appendix K should be retained within the audit standards.

Lead Auditor's Responsibility in a Multi-Tiered Audit

The Supplemental Release includes amendments to the auditing standards that may suggest the ability of the lead auditor to delegate supervisory responsibility. We believe that the lead auditor must be responsible for the proper planning, supervision, and execution of the entire audit.

We question, however, the threshold set forth in the Supplemental Release that a lead auditor need only audit 50 percent or more of the company's assets or revenues (a significant portion of the audit). We believe the lead auditor's analysis as to whether it can reasonably serve as the lead auditor must consider all the facts and circumstances rather than simply consolidated assets or revenues. In certain cases, income from continuing operations or another quantitative metric may be more relevant.

⁵ The SECPS was administratively created by the AICPA in 1977, in consultation with the SEC, and required member public accounting firms to subject their professional practices to peer review and oversight by the POB and the SEC. AICPA membership requires that members who provide attest services to an SEC client be employed by or affiliated with a public accounting firm that is an SECPS member. The SECPS was dissolved upon the termination of the Public Oversight Board on May 1, 2002.



Thank you for your consideration of our views and perspectives. If you have any questions or seek further elaboration of our views, please contact Robert P. Peak at robert.peak@cfainstitute.org or Sandra J. Peters at sandra.peters@cfainstitute.org.

Sincerely,

/s/ Sandra J. Peters

Sandra J. Peters, CPA, CFA
Senior Head, Global Financial Reporting Policy Advocacy
CFA Institute



November 30, 2021

Public Company Accounting Oversight Board
comments@pcaobus.org

Re: PCAOB Rulemaking Docket Matter No. 042, *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,

CohnReznick appreciates the opportunity to comment on the above mentioned matter. CohnReznick is the 16th largest accounting firm in the U.S., with its origins dating back to 1919.

We support the PCAOB in its overall mission to protect investors and further the public interest in the preparation of informative, accurate, and independent audit reports. While our domestic and international capabilities (including through our Nexia International membership) allow us to serve a broad array of clients, we are a significant provider of services to the smaller and middle market. Our desire is that our response to the exposure draft will give you perspective into the unique impact these changes might have on small and medium size entities and their ability to attract capital.

Our responses to specific questions on which the PCAOB is seeking comment are included in the attachment to this letter.

If you have any questions concerning our comments or would like to discuss any of our responses or recommendations in more detail, please feel free to contact Steven Morrison, Partner, National Director of Audit, at 646-601-7740 or steven.morrison@cohnreznick.com.

Yours truly,

A handwritten signature in black ink that reads "CohnReznick LLP". The signature is written in a cursive, flowing style.

OVERALL RESPONSE

We support the development of the proposed PCAOB Rulemaking Docket Matter No. 042, *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*, and believe the proposed standards may serve the public interest.

We recommend the PCAOB add additional application guidance throughout focusing on small and medium size firms working on lesser complex entities. We believe such will be helpful for all firms in navigating implementation of the proposed standards, particularly in regards to tangential issues that were not the main focus in standard setting.

SPECIFIC RESPONSES

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

In recent years, other than changes to auditor practices necessitated by different risk assessments in any one year, we have not seen material changes to 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?

The changes we have observed with regard to multinational company audits are consistent with changes to non-multinational audits as the COVID-19 pandemic. That is, primarily the increased use of remote working technologies spurred, in part, by travel restrictions imposed by governmental bodies.

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?

While we find the definitions overall to be clear, we do express concern with introducing yet another set of definitions to what are in effect, analogous concepts. The ISAs and AU-Cs discuss the concept of a “group” auditor and “components” and in extant PCAOB, the concept of “principal auditor” and “other independent auditors” from pre-Clarified US GAAS are also discussed. While the ISAs and AU-Cs approach these concepts from an entity perspective and PCAOB standards approach more from an auditor perspective, many of the underlying parties involved are in effect the same parties but with different names. Given that multinational audits often involve foreign auditors who might be accustomed to the ISAs, we believe audit quality may be better facilitated if PCAOB standards and the ISAs/AU-Cs were aligned more

closely. Given the noticeable differences in focus, we recommend in the near term that the PCAOB liaise with both the IAASB and the AICPA Auditing Standards Board and jointly develop non-authoritative materials that US and foreign auditors could use to better align expectations and more quickly identify audit quality issues which may be present that have not been detected¹.

- 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?**

We believe 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 are appropriate and clear.

- 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?**

We believe the proposed requirements relating to the lead auditor's responsibilities regarding other auditors' compliance with the independence and ethics requirements are appropriate. We believe the linkage to Rule 3526, which has been in effect for the better part of two decades, will be effective in generating consistency in the lead auditor's application of the proposed standard.

However, we believe practical challenges will exist initially particularly with foreign firms that are not a part of the same network as the lead auditor or that have a less robust independence and conflict check system than the global firms. A figurative learning curve may present complications upon the proposed standard becoming effective. In order to help facilitate audit quality, we recommend the PCAOB perform outreach to the networks not associated with the global firms.

- 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?**

We believe the proposed amendments relating to the knowledge, skill, and ability of the other auditor revised by this release are clear and appropriate. We support the

¹ Although the AU-Cs are substantially converged with the ISAs, there are some substantial differences, one of which is that the AU-Cs permit referencing another auditor, whereas the ISAs do not.

usage of similar wording and concepts as noted in endnote 4H. We believe such will enable operationality and contribute to audit quality.

- 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?**

We believe 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 are appropriate and clear. Regarding practical challenges that may arise, we believe a number of such could be avoided or mitigated by the PCAOB having extensive implementation and application guidance available similar to how the PCAOB did for the recently implemented specialists and estimates standards.

- 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?**

We believe the proposed requirements for multi-tiered audits 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, are overall clear and overall appropriate. We do have concerns about the application of this in practice, in particular, among the non-global firm environment where firm “associations” and “networks” may not be as structured as Big Four networks and thus the flow of information between firms may not be as clear and effective. We recommend the PCAOB provide application guidance that includes examples of situations that may trigger the proposed AS 2101.06F.

- 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**

We believe the proposed requirements noted in regard to question 9a is clear and appropriate.

- 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?**

We believe the proposed requirements noted in regard to question 9.b is clear and appropriate. We do have concerns about the application of this in practice, in particular, among the non-global firm environment where firm “associations”

and “networks” may not be as structured as Big Four networks and thus the flow of information between firms of what each firm does, and does not do, may not be as clear and effective. We recommend the PCAOB provide application guidance that includes examples of what the PCAOB views as appropriate and inappropriate.

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?

Please see 9.b above.

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

We believe the modifications in proposed AS 1206, including Appendix B, to reflect the auditor’s report language in AS 3101 are appropriate and clear.

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?

We believe the proposed amendments to AS 1105.B1 to guide auditors in equity method investment circumstances are clear and appropriate. We agree with the PCAOB’s observations in the proposed standard’s PCAOB Rulemaking Docket Matter No. 042 that “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.”

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?

We are not aware of any other data sources the Board should consider in establishing the baseline-for evaluating economic impacts of which the Board should be aware.

Are there additional academic research papers or external reports of which the Board should be aware?

We are not aware of any 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?

We are not aware of any additional economic problems associated with the use of other auditors related to this PCAOB Rulemaking Docket Matter No. 042 referenced in this letter.

Would the revised proposed amendments result in economic impacts or unintended consequences beyond those described in the 2016 Proposal?

Overall, we did not identify specific circumstances in the revised proposed amendments that may result in economic impacts or unintended consequences beyond those described in the 2016 Proposal. However, we do call attention to both the “known unknowns,” the effects we know we do not know, and also the “unknown unknowns,” that is, those effects we do not know we do not know. As such, we recommend extensive application guidance with examples to reflect the PCAOB’s intent.

Are there any other matters not addressed in this release that the PCAOB should consider in its economic analysis?

We recommend the PCAOB consider the difficulties encountered and resources used by firms in complying with PCAOB standards, AICPA AU-Cs, and IAASB ISAs. All are high quality standards, particularly when one strips away independence requirements. By having to maintain different or overlapping methodologies, the resources of firms, from staff through partner level, both on the engagement teams and in national office functions, are pulled away from the pure concept of performing high quality audits. We recommend the PCAOB evaluate the cost-benefit to the public interest of the PCAOB having a completely different set of standards versus having purely incremental standards to US GAAS.

PCAOB Rule Making Docket No. 042**Response to Request for Public Comment on the PCAOB's
Proposed New Requirements for Lead Auditors Use of Other Auditors**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

I hope you find these comments helpful.

Sincerely,

Robert A. Conway, CPA

RetiredAuditPartnerACAP@Live.com

Via Email

October 28, 2021

Office of the Secretary
PCAOB
1666 K Street, NW
Washington, DC 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 042

Dear Madam Secretary:

I am writing on behalf of the Council of Institutional Investors (CII), a nonprofit, nonpartisan association of U.S. public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately \$4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families, including public pension funds with more than 15 million participants – true “Main Street” investors through their pension funds. Our associate members include non-U.S. asset owners with about \$4 trillion in assets, a range of asset managers with more than \$40 trillion in assets under management, the five largest accounting firms and the Center for Audit Quality.¹

The purpose of this letter is to respond to the Public Company Accounting Oversight Board (PCAOB or Board) request for “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” (Proposed Amendments).²

CII membership approved policies reflect the view that:

Audited financial statements including related disclosures are a critical source of information to institutional investors making investment decisions. The efficiency of global markets—and the well-being of the investors who entrust their financial present and future to those markets—depends, in significant part, on the quality,

¹ For more information about the Council of Institutional Investors (“CII”), including its board and members, please visit CII’s website at <http://www.cii.org>.

² 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 at 1 (Sept. 28, 2021), https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/rulemaking/docket042/2021-005-other-auditors-ssrc.pdf?sfvrsn=6000f093_4.

comparability and reliability of the information provided by audited financial statements and disclosures. The quality, comparability and reliability of that information, in turn, depends directly on the quality of the . . . standards that . . . auditors use in providing assurance that the preparers' recognition, measurement and disclosures are free of material misstatements or omissions. The result should be timely, transparent and understandable financial reports.³

Generally consistent with our policy, we share the view of Megan Zietsman, former Board member, that the Proposed Amendments, "if adopted, will improve how auditors plan and supervise audits that involve other auditors; which in turn will enhance audit quality and protect the interests of investors"⁴

We note that the Proposed Amendments include only one "Request for Comment" that is explicitly directed at investors.⁵ That request for comment states: "The Board requests further comment, including any available empirical data, on how the proposed amendments discussed in this release would specifically affect audits of [Emerging Growth Companies (EGCs)]⁶ EGCs and on whether the proposed amendments would protect investors and promote efficiency, competition, and capital formation."⁷ In response to this question, CII shares the PCAOB's view that "if [the Board] . . . adopts the proposed amendments, it will request that the [U.S. Securities and Exchange] 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.*"⁸

³ Council of Institutional Investors, Policies on Other Issues, **Independence of Accounting and Auditing Standard Setters** (Adopted, Mar. 10, 2020), https://www.cii.org/policies_other_issues#indep_acct_audit_standards.

⁴ Megan Zietsman, Board Member, Statement in Support of the Issuance of a Supplemental Request for Comment on Proposed Amendments to Auditing Standards Related to the Auditor's Supervision of Other Auditors (Sept. 28, 2021), <https://pcaobus.org/news-events/speeches/speech-detail/statement-in-support-of-the-issuance-of-a-supplemental-request-for-comment-on-proposed-amendments-to-auditing-standards-related-to-the-auditor-s-supervision-of-other-auditors>; see Duane M. DesParte, Acting Chairperson, Statement on Second Supplemental Request for Comment: Proposed Amendments to Auditing Standards Related to the Supervision of Audits Involving Other Auditors (Sept. 28, 2021), <https://pcaobus.org/news-events/speeches/speech-detail/statement-on-second-supplemental-request-for-comment-proposed-amendments-to-auditing-standards-related-to-the-supervision-of-audits-involving-other-auditors> (commenting that "investor protection can be further enhanced by increasing the required involvement of lead auditors in planning and supervising the work of other auditors.").

⁵ PCAOB Release No. 2021-005 at 66 (emphasis omitted).

⁶ See, e.g., U.S. Securities and Exchange Commission, Small Business, Emerging Growth Companies (last visited Oct. 26, 2021), <https://www.sec.gov/smallbusiness/goingpublic/EGC> ("A company qualifies as an emerging growth company if it has total annual gross revenues of less than \$1.07 billion during its most recently completed fiscal year and, as of December 8, 2011, had not sold common equity securities under a registration statement.").

⁷ PCAOB Release No. 2021-005 at 66.

⁸ *Id.* (emphasis added).

Page 3 of 3
October 28, 2021

Our support for the Board's view that the Proposed Amendments should be applied to the audits of EGC's is based on the following factors:

- Our agreement with the Board finding that commentators to prior iterations of the Proposed Amendments "generally supported applying the proposed amendments to audits of EGCs, citing benefits to users of EGC financial statements."⁹
- Our agreement with the Board finding that "the benefits to audit quality achieved through improved planning and supervision of audits involving other auditors may be especially significant for EGCs."¹⁰
- Our agreement with the Board finding that 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."¹¹

Acting Chairperson Duane M. Desparte has stated that "it is . . . imperative that [the PCAOB] . . . finish this important project . . . to better ensure the lead auditor plays a central role in determining the scope of audit procedures and in coordinating and supervising effective execution of such procedures by other audit firms on the engagement . . . [and, thereby] drive improved audit quality and investor protection."¹² CII agrees.

We appreciate your consideration of our comments. Please let me know if you have any questions.

Sincerely,



Jeffrey P. Mahoney
General Counsel

⁹ *Id.* at 63.

¹⁰ *Id.* at 65.

¹¹ *Id.*

¹² Duane M. DesParte, Acting Chairperson, Statement on Second Supplemental Request for Comment: Proposed Amendments to Auditing Standards Related to the Supervision of Audits Involving Other Auditors.

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November 30, 2021

Public Company Accounting Oversight Board
comments@pcaobus.org

Re: PCAOB Rulemaking Docket Matter No. 042

To the Board:

Crowe LLP appreciates the opportunity to comment on the 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*, as per PCAOB Release No. 2021-005 dated September 28, 2021 ("2021 SRC" or "the proposal").

We agree that the unique challenges associated with the use of other auditors in an audit engagement can impact audit quality. We support the issuance of an updated, modernized standard that would drive increased audit quality and less diversity in practice related to a lead auditor's supervision of other auditors. We appreciate the modifications made to the 2021 SRC, which are responsive to some of the feedback provided in the 2017 supplemental request for comment ("2017 SRC").

Other standard setters are currently making modifications to their audit standards related to group audits and the use and supervision of other auditors. For example, in April of 2020 the International Auditing and Assurance Standards Board issued an Exposure Draft *Proposed International Standards on Auditing 600 (Revised): Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors) and Proposed Conforming and Consequential Amendments to Other ISAs* ("Proposed ISA"). The final standard is expected to be issued later this year. The IAASB proposal has similar goals related to better communication between lead and component auditors, more consistency in the application of the standard, and improving audit quality. The Auditing Standards Board is currently drafting an Exposure Draft on this topic, as well, which is expected to be issued during the first quarter of 2022 and anticipated to be largely convergent with the Proposed ISA. We believe it is important that all three standards have compatible requirements to achieve the common objective of improving audit quality.

Overall and Background

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?*

The biggest changes related to auditor practices and the interactions between lead auditors and other auditors primarily pertain to advancements in technology resulting in the ability to work virtually / remotely, and new means and methods for the sharing and exchange of information. These changes have reduced the impact that *physical* location – of human resources as well as audit evidence and documentation – have on the way in which audits are executed. These same changes impact how issuers prepare their financial reporting and implement internal controls over financial reporting. The COVID-19 pandemic accelerated the pace of change because of imposed restrictions on traveling and gathering in groups, though many firms and issuers operated in a hybrid work environment pre-pandemic.

Specifically, the enhanced ability to effectively work remotely means that audit engagement teams (and issuer personnel) are influenced less by *where they are physically located* and more by *how the professionals work together and the mediums through which they communicate*. Further, workpapers and documentation that used to exist primarily in manual form are, more and more, originated as or transformed into digital form. Elements of the 2021 SRC seem to be focused on the physical location of auditors or client personnel. While this is a factor in determining how to interact or perform audit procedures; the ability to communicate, view and exchange information, and perform audit procedures is not precluded (in many cases) by lack of physical proximity. The issued standard should be responsive to the current work environment and flexible enough to support the expected continuing evolution in technology and where and how audits can be performed.

Definitions

Question 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?*

Yes, we believe these definitions are sufficiently clear. Specifically, we appreciate the inclusion of “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...” as part of the lead auditor. This principles-based definition allows for the appropriate inclusion of employees of shared service centers, temporary employment agencies, inventory counting services, and others who, in effect, function as the firm’s employees as part of the lead auditor.

Planning the Audit

Question 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?*

We appreciate the revisions to the 2017 SRC which are reflected in the 2021 SRC, related to the lead auditor’s responsibilities regarding other auditors’ compliance with the independence and ethics requirements. Related to the proposal, we believe it is important for the PCAOB to consider the International Ethics Standards Board for Accountants’ group audits independence project in finalizing the proposed revisions to the standards.

Supervising Other Auditors

Question 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?*

We agree that the lead auditor takes responsibility for the overall audit process through the direction and supervision of other auditors, and that sufficient and appropriate supervision by the lead auditor is critical to audit quality. However, the proposals in the 2021 SRC may not be sufficiently flexible to reflect the manner and frequency with which lead auditors and other auditors interact, including for purposes of risk assessment and the design (and execution) of further audit procedures.

Communication About Risks of Material Misstatement

The proposal indicates that “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 ...; and With respect to the work requested to be performed: the identified risks of material misstatement, tolerable misstatement, and the amount (if determined) below which misstatements are clearly trivial and do not need to be accumulated.” We believe that this communication would occur based on the lead auditor’s initial planning of the audit including the scope related to multiple locations and business units (further communications may occur, based on the iterative nature of risk assessment). This proposed requirement is critically integrated with the retained portions of the engagement standards which 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. Two-way communication between the lead auditor and the other auditor is critical to the identification of risks of material misstatement and the development of appropriate audit responses.

Required Written Communications Related to Other Auditors’ Responsibilities and Audit Procedures to Be Performed by the Other Auditors

The proposal indicates that “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 and the general type of work to be performed, which could range from a few specified audit procedures to a standalone audit).” In addition, 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, 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.

Again, we agree that sufficient and appropriate supervision by the lead auditor is critical to audit quality. We also appreciate that there are a number of unique challenges related to communication and coordination between lead auditors and other auditors. The 2021 SRC indicates that the intent of these requirements is to provide flexibility to accommodate different situations, such as when an other auditor has a depth of knowledge about a business unit and maybe be more involved in determining further audit procedures for that business unit, as well as when the lead auditor’s necessary extent of supervision may result in the lead auditor being more prescriptive about the audit procedures to be done for the business unit. However, we believe that the requirement for each of these communications to occur in writing is not reflective of how lead auditors and other auditors currently interact and exchange information.

As stated earlier in this letter, two-way communication between the lead auditor and the other auditor is critical to the identification of risks of material misstatement and the development of appropriate audit responses. To be most effective, these interactions should occur frequently and may take place throughout the audit, based on the iterative nature of risk assessment. We believe that current standards, and elements of standards proposed to be retained with the 2021 SRC, have requirements that drive these communications. The requirement to communicate, in writing, all exchanges related to any risks of material misstatement, designed audit responses, changes to designed audit responses (all relative to the work to be performed by the other auditor), is overly prescriptive and does not reflect the manner in which many lead auditors and other auditors interact.

The initial communication by the lead auditor to the other auditor about the scope of work, type of work to be performed, initial risk assessment, and certain materiality assessments should be in writing in accordance with the standards in planning the audit and supervision. The final procedures performed by

the other auditor and the results of those procedures should also be communicated in writing, to support the lead auditor's assessment of the results and determination that the audit procedures are sufficiently responsive to the identified risks. During the course of the audit, based on advancements in technology and changes in the way lead auditors and other auditors work together (as discussed earlier in this letter), lead and other auditors can and frequently do communicate in other ways, such as during video meetings. This is frequently used as a way for lead auditors to supervise other auditors. During such video meetings or other real-time remote conversations, lead and other auditors are able to exchange information about risk assessment, planned audit responses, and results. These discussions may result in changes to the audit plan which are appropriate based on the communication and collaboration between the lead and other auditors. During such discussions, the lead auditor is also clarifying with engagement team members (the other auditor) their responsibilities for the audit, as required by AS 1201. The requirement to document each and every such exchange in writing would be time consuming and costly while, in many cases, not driving an increase in audit quality. The proposed amendments are meant to be scalable, whereby the lead auditor determines the extent of supervision of the other auditors' work in accordance with paragraph .06 of AS 1201. Given that, we believe the lead auditor should be able to apply their judgment in determining which of these frequent interactions need to be formally communicated in writing in order to ensure that the parties to the communications are fully aware of the modifications from the most recent written communications. In accordance with AS 1215.12f, this would include *significant* changes in the auditor's (lead auditor or other auditor) risk assessments and the modifications to audit procedures or additional audit procedures performed in response to those changes.

Proposed Effective Date

The 2021 SRC indicates that "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 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)". We don't believe that the proposed effective date allows firms enough time to prepare for implementation of the proposed amendments and proposed standard. Many of the changes proposed relate to planning the audit to determine the scope and the involvement of other auditors, which activity occurs early in the audit engagement. Audit firms need sufficient time to update firm methodology, tools, and guidance as well as provide training on the final revised and new standards. We recommend that the final revised and new standards should be required no sooner than for audits of fiscal years beginning two years after approval by the SEC (or three years if SEC approval occurs in the fourth quarter).

We would be pleased to respond to any questions regarding our observations noted within this letter. If there are any other questions regarding this subject, please contact Kyle Owens at 630.575.4265 or Linda Poeschel at 630.586.5258.

Sincerely,

A handwritten signature in black ink that reads "Crowe LLP". The signature is written in a cursive, flowing style.

Crowe LLP



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November 29, 2021

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Public Company Accounting Oversight
Board
1666 K Street, NW
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Re: PCAOB Rulemaking Docket Matter No. 042

Deloitte & Touche LLP (“D&T” or “we”) is pleased to respond to the request for comments from the Public Company Accounting Oversight Board (the “PCAOB” or the “Board”) on PCAOB Release No. 2021-005, *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* (“the 2021 Proposal” or “the 2021 Release”), which addresses certain revisions to PCAOB Release No. 2017-005, *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*, from September 27, 2017 (collectively, “the 2017 Proposal” or “the 2017 Release”) and PCAOB Release No. 2016-002, *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard — Dividing Responsibility for the Audit with Another Accounting Firm*, from April 12, 2016 (collectively, “the 2016 Proposal” or “the 2016 Release”) as well as other matters related to audits that involve accounting firms and individual accountants outside the accounting firm that issues the audit report.

OVERALL COMMENTS

We support the Board’s efforts to enhance the standards of the PCAOB that address audits involving accounting firms and individual accountants outside the accounting firm that issues the auditor’s report and to align the applicable requirements with the PCAOB’s risk-based standards. These situations are common in today’s global economy in which companies have operations throughout the world and workforces are increasingly remote.

Similar to our [2017 response](#) and [2016 response](#) to requests for comment on the 2017 Release and 2016 Release, respectively, we are supportive of the objectives of the Board’s 2021 Proposal. We commend the Board for its responsiveness to commenters’ suggestions for further improvement as demonstrated through the additional revisions in the 2021 Proposal. We offer certain constructive suggestions in this letter with the objective of having a final standard that clarifies the lead auditor’s responsibilities with respect to other auditors, including providing additional factors to consider on how to apply the principles-based supervisory requirements of the standards, including when a referred-to auditor is involved. A brief summary of the key matters for additional consideration that we have identified are as follows, with further detailed comments in [Appendix 1](#)):

Definition, Roles, and Responsibilities of the Lead Auditor. We believe the consideration of multiple criteria is important when determining which registered accounting firm can act as the lead auditor. We support the proposed amendments related to serving as the lead auditor; however, we recommend further modifications to give appropriate recognition to qualitative factors that are critical in determining the sufficiency of the lead

auditor's participation in the audit. We also offer suggestions to clarify the 2021 Proposal related to the definition of lead auditor and secondees.

Dividing Responsibility for the Audit with Another Accounting Firm. We fully support the continued practice of enabling registered accounting firms to make reference to the audit of an other auditor in the auditor's report. Our observations and recommendations serve to preserve and enhance a longstanding and necessary practice.

Multi-Tiered Audits and Audit Documentation. Accounting firms continue to evolve and innovate in terms of organizational structure, engagement team composition, and audit execution techniques. Having professional standards that can be operationalized in an environment in which work structures and the nature of audit evidence continues to change is critical to the execution of high-quality audits. We offer suggestions that recognize how audits are being enhanced by new technologies.

Effective Date. We strongly recommend an effective date for audits with fiscal years beginning no sooner than two years after the approval by the Securities and Exchange Commission (SEC) (or for audits of fiscal years beginning three years after the year of SEC approval if that approval occurs in the third or fourth quarter). It is essential that public accounting firms have sufficient time to determine the impacts of the PCAOB's 2021 Proposal, including in relation to the International Auditing and Assurance Standards Board's (IAASB) standards, particularly Proposed International Standard on Auditing (ISA) 600 (Revised), *Audits of Group Financial Statements (Including the Work of Component Auditors)*, in order to enable consistent global implementation.

We also offer editorial comments in [Appendix 2](#).

* * *

D&T appreciates the opportunity to provide our perspectives on these important topics. The potential benefits of the 2021 Proposal are significant and, while some of these considerations are complex and challenging, we do not believe any should stand in the way of completing this important project. We stand ready to engage constructively with the Board and other stakeholders to provide our perspective and experiences in order to facilitate the finalization of the PCAOB's auditing standards that will enhance audit quality. If you have any questions or would like to discuss these issues further, please contact Jennifer Haskell at 203-761-3394 or Dora Burzenski at 206-716-7881.

Very truly yours,



Deloitte & Touche LLP

cc: Duane M. DesParte, Acting PCAOB Chairperson
Christina Ho, PCAOB Member
Kara M. Stein, PCAOB Member
Barbara Vanich, PCAOB Acting Chief Auditor

Gary Gensler, SEC Chairman
Hester M. Peirce, SEC Commissioner
Elad L. Roisman, SEC Commissioner
Allison Herren Lee, SEC Commissioner
Caroline A. Crenshaw, SEC Commissioner
Paul Munter, SEC Acting Chief Accountant
Richard R. Jones, FASB Chairman

APPENDIX 1

Definition, Roles, and Responsibilities of the Lead Auditor

As articulated in the “Overall Comments” section of this letter, we recognize and support the Board’s objectives and believe that sufficient oversight and involvement by the lead auditor in an audit that involves other accounting firms is critical to audit quality. We fully support strengthening requirements in the PCAOB’s standards in this area. As noted in the 2016 and 2017 Releases, many accounting firms and networks, including the Deloitte network, have adopted requirements and guidance beyond the requirements of existing AS 1205, and we believe embedding leading practices into the standards of the PCAOB is appropriate and will be beneficial to audit quality.

Serving as the Lead Auditor (2021 Release Question #4). We believe the consideration of multiple criteria is important when determining which registered accounting firm can, and should, act as the lead auditor, and we commend the Board in being responsive to previous requests for comment by expanding PCAOB AS 2101.06A to include additional factors beyond just the consideration of the risks of material misstatement; however, we believe additional changes are needed in the area of determining sufficiency of participation to serve as lead auditor.

Since the 2016 and 2017 Releases, we have continued to see advancements in how companies and their personnel, financial reporting systems, and related data are organized, including organizational structures whereby executives and key decision makers are physically located away from any operations of the company or companies that are entirely virtual (i.e., there is no office or physical work site where employees work). In addition, there are situations in which importance, risk, and extent of supervision may lead to more than one conclusion about the lead auditor, and other situations where determination based on importance, risk, and extent of supervision may conflict with auditor licensing requirements based on the legal domicile of the company. We recognize that page 16 of the 2021 Release clarifies that the requirement to consider the engagement partner’s firm’s extent of supervision of other auditors’ work is intended to address these scenarios; however, we suggest that the proposed standard provide explicit wording that the lead auditor determination is also based on these factors (i.e., legal domicile, licensing requirements, location of company executives, location of primary financial reporting decision-making, location where the consolidated financial statements are prepared, as well as situations where no single accounting firm audits a more than minor portion of the total work). This explicit wording would be consistent with existing AS 1205.02, which acknowledges there can be circumstances in which the other auditors perform a large portion of the work and in which the lead auditor’s participation in the other auditors’ work is sufficient based on the extent of their knowledge of the overall financial statements, among other factors.¹

In addition, while we acknowledge the PCAOB’s perspective that affiliation through a network does not automatically provide the lead auditor with an understanding of the other affiliates’ processes and experiences (page 24 of the 2021 Release), we believe that if a shared system of quality control at the network level exists and is operating effectively, reliance by the lead auditor on such commonalities can influence the nature, timing, and extent of direction and supervision of other auditors from the same network. A shared system of quality control, when operating effectively, provides shared methodologies and a common “language” and understanding that is distinct from other auditors outside of the network. We suggest that the proposed standard recognize this distinction as part of its risk-based, scalable approach to direction and supervision.

Additional Considerations When Serving as the Lead Auditor. As noted in the previous comment, we are supportive of including additional items for the lead auditor to consider as they determine whether they can serve as the lead auditor. We also have incremental observations related to proposed AS 2101.06A.a, which states, “In making this determination, the engagement partner should take into account the following... a. The importance of the locations or business units for which the engagement partner’s firm performs audit procedures

¹ See Deloitte’s comment letters in response to the 2016 and 2017 Releases for further explanation of this concern and examples of situations in which the lead auditor does not audit a significant portion of the company’s operations.

in relation to the financial statements of the company as a whole, considering quantitative and qualitative factors” We note that in identifying and assessing the risks of material misstatement in a multilocation audit, the auditor is required to consider the factors in proposed AS 2101.12. As we believe these factors already address the “importance” of the locations or business units for which the lead auditor is performing procedures as well as “the consideration of quantitative and qualitative factors,” the incremental effort that would be expected to “take into account importance” is not apparent. We therefore recommend that a specific reference to proposed AS 2101.12 be included in this factor. In addition, if the Board believes that consideration of the items in proposed AS 2101.12 may not adequately address the requirement in proposed AS 2101.06A, we recommend the Board identify the additional factors to be considered.

Consistent Definition of Engagement Team Across All Standards. The term “engagement team” is defined in proposed AS 2101.A3; however, the definition is only for purposes of proposed AS 2101, proposed AS 1206, and proposed AS 1201. We are concerned that there are implications to other standards when applying the new proposed amended definition of “engagement team.” We encourage the PCAOB to revisit instances of the term “engagement team” in existing standards² (including those not contemplated in the 2021 Release) and determine whether there are implications to those standards when applying the new proposed amended definition. In addition, we have specific observations with the following paragraphs:

- Proposed AS 1220.10d states, “In an audit, the engagement quality reviewer should ... d. Review the engagement team’s evaluation of the firm’s independence in relation to the engagement.” Proposed AS 2101.06D requires that in an audit that involves other auditors, the lead auditor should, with respect to each other auditor, perform procedures in conjunction with determining compliance with SEC independence requirements and PCAOB independence and ethics requirements. Therefore, we believe that it would only be relevant for the engagement quality reviewer to review the lead auditor’s evaluation of the firm’s independence in an audit that involves other auditors. However, as written, given that the term “engagement team” includes other auditors, proposed AS 1220.10d would require the engagement quality reviewer to pierce through and review other auditor’s independence conclusions (versus reviewing the lead auditor’s conclusions). As such, we recommend the PCAOB modify proposed AS 1220.10d to reflect that the engagement quality reviewer reviews the lead auditor’s evaluation of the firm’s independence.
- AS 1220.10j states, “In an audit, the engagement quality reviewer should ... Based on the procedures required by this standard, evaluate the engagement team’s determination, communication, and documentation of critical audit matters in accordance with AS 3101, *The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion.*” We believe that it would only be relevant for the engagement quality reviewer to evaluate the lead auditor’s determination, communication, and documentation of critical audit matters in an audit that involves other auditors; we therefore recommend the PCAOB modify AS 1220.10j to reflect this recommendation.

In addition, we observe that page 29 of the 2021 Release implies the PCAOB’s intent is that only other auditors (not referred-to auditors) would be deemed key engagement team members.

Page 29: “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.”

As a result, we recommend that the PCAOB explicitly state this in the PCAOB standards, and therefore revise footnote 15 to proposed AS 1201.08 and proposed AS 2110.50.

Serving as the Lead Auditor When Referring to Another Auditor. Proposed AS 2101.06A states, “In addition, in an audit that involves referred-to auditors (see AS 1206), the participation of the engagement partner’s firm

² Examples of standards in which the term “engagement team” is used include AS 1015, AS 1210, AS 1215, AS 1220, AS 1301, AS 2110, AS 2201, AS 2301, AS 2410, AS 2810, AS 3101, AS 4105, and AS 6115.

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." Use of the term "or" in that phrase means that either assets or revenues alone could preclude the lead auditor from making reference to a referred-to auditor. There are scenarios in which either assets or revenues audited by the referred-to auditor are greater than the assets or revenues audited by the lead auditor, such as when consolidated revenues of the company overall are nominal, however the amounts that do exist are audited by the referred-to auditor. If the goal of the PCAOB is to ensure that the lead auditor does not refer to another auditor in situations in which they haven't sufficiently participated, then use of "or" will allow for false positives and restrict the ability of the lead auditor to appropriately make available to them the option of making reference. Therefore, we recommend modifying proposed AS 2101.06A as follows:

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 and ~~or~~ revenues.

Existence of Lead Auditor (2021 Release Question #3). We believe there is a lack of clarity on whether the firm issuing the auditor's report is a "lead auditor" when the audit does not involve other auditors or referred-to auditors. This may create confusion as to who is responsible for fulfilling certain requirements in the standards as well as confusion as to the composition of the engagement team. For example:

- Proposed AS 2101.04 and proposed AS 2101.06A imply that a lead auditor exists only when the audit involves other auditors or referred-to auditors.
- Proposed AS 2101.A4 defines the term "lead auditor" but is silent as to whether an other auditor or referred-to auditor needs to also exist.
- However, proposed AS 2101.A3 defines the term "engagement team" to include "(1) partners, principals, and shareholders of, and accountants and other professional staff employed or engaged by, the lead auditor..." and "(2) specialists who (i) are employed by the lead auditor..." Therefore, the definition of "engagement team" appears to be contingent upon the existence of a lead auditor. We suggest that the proposed standard explicitly acknowledge, indicative of the PCAOB's intention, either: (1) the registered public accounting firm that issues the auditor's report is always the lead auditor, including when there are no other auditors or referred-to auditors or (2) the registered public accounting firm that issues the auditor's report is only a lead auditor if the audit involves other auditors or referred-to auditors (and therefore modifications would need to be made to the definition of engagement team).

Secondees (2021 Release Question #3). The definition of "lead auditor" in the Appendix to proposed AS 2101 states, "Individuals such as secondees 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." Footnote 5 to the Appendix goes on to state "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)." Over the past few years, there has been a shift in how secondees are managed. Often, secondees from one country do not physically relocate to where the country and office of the registered public accounting firm issuing the auditor's report is located. We believe that an employee from one country should be able to be considered "seconded" even if they don't physically relocate, as long as they meet the remaining requirements of footnote 5. We recommend that the PCAOB modify footnote 5 to reflect this view as well as to be consistent with current practice and to address the evolving nature of remote and virtual workforces. We acknowledge that Form AP guidance uses similar language for secondment arrangements, and we recommend that consistent modifications also be made to such guidance.

Dividing Responsibility for the Audit with Another Accounting Firm

The ability for the lead auditor to divide responsibility for the audit with another accounting firm is a recognized and allowable approach in the United States, and there are no compelling practice issues we are aware of that would suggest a need to change an approach that has long been permitted. Therefore, we do not believe that additional requirements, including supervisory requirements, are necessary to describe the responsibilities of the engagement partner's firm in situations in which the lead auditor divides responsibility for the audit. We believe that certain aspects of proposed AS 1206 are in conflict with the Board's goals with respect to divided responsibility, and we further describe our observations and recommendations below.

The Principles Underlying Division of Responsibility. Currently, the decision to divide responsibility most often happens when a significant transaction occurs toward the end of the fiscal year and the lead auditor determines that they will not have appropriate time to assume responsibility for work performed by the other auditor. It could also occur when there is an investment accounted for using the equity method along with an inability to obtain unfettered access to the necessary people and information in order to assume responsibility for the work of the investee auditor. In such circumstances the auditor's report provides transparency to the users of the audited financial statements about the responsibility taken by the lead auditor, as often evidenced with language similar to: "Our opinion insofar as it relates to Subsidiary B is based solely on the opinion of the other auditor."

The 2021 Proposal, however, contains additional requirements that go beyond current practice and that may result in more opaqueness around the responsibility and activities the lead auditor is required to undertake with respect to the referred-to auditor. Specifically, proposed AS 2101.14, proposed AS 2110.11A, and proposed AS 2401.53 as it relates to the lead auditor's involvement in the referred-to auditor's audit are not consistent with the principles underlying dividing responsibility.

The 2017 Release (page 28) discusses the diminishing of the clear line between assuming and dividing responsibility by referencing consistency with the following existing requirement in AS 1205.10, which states:

He also should adopt appropriate measures to assure the coordination of his activities with those of the other auditor in order to achieve a proper review of matters affecting the consolidating or combining of accounts in the financial statements....

We respectfully submit our view that the proposed changes are not consistent with the current AS 1205, including AS 1205.10. We therefore recommend, consistent with our 2016 and 2017 comments,³ that the Board remove the requirements in proposed AS 2101.14, proposed AS 2101.06A.b as it relates to referred-to auditors, proposed AS 2110.11A, and proposed AS 2401.53, as we do not believe these activities are necessary in a scenario in which a referred-to auditor is involved, nor are they required to be performed today.

Disclosures. Proposed AS 1206.08(c) states that the lead auditor's report should "[d]isclose 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." Furthermore, the second note to proposed AS 1206.01 states that "[t]his 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-.09 of this standard [AS 1206] in relation to each of the referred-to auditors individually." In current practice, if there is more than one referred-to auditor, the auditor's report generally combines the disclosure about the magnitude of the portion of the company's financial statements and, if applicable, internal control over financial reporting, for all referred-to auditors, which has been a longstanding and accepted practice with auditor's reports filed with the SEC. We recommend that the Board clarify whether the intention is to require that this information be disclosed for each referred-to auditor individually and consider, in making this clarification, how this would conflict with current practice and what is currently acceptable to the SEC.

In addition, we believe the following edit to proposed AS 1206.08(c) is important as it provides the necessary flexibility as to the criteria that are used and referred to in the auditor's report. The existing use of "and"

³ See the Deloitte comment letters for the 2016 and 2017 Releases for further discussion on this topic.

implies that the criteria used and referred to always includes total assets and total revenues and other appropriate criteria; however, this is not always the case. Furthermore, we note that Section 4140.3 of the FRM only requires that the principal auditor's report "indicate clearly the division of responsibility between the principal auditor and the other auditor...." and does not state the criteria that must be considered or referred to:

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, ~~or~~ **and** other appropriate criteria necessary to identify the portion of the company's financial statements audited by the referred-to auditor.

Multi-Tiered Audits and Audit Documentation (2021 Release Questions #1, #2, #7, and #8)

Accounting firms continue to evolve and innovate in terms of organizational structure, engagement team composition, and audit execution techniques. This means that:

- Engagement team members may not all be from the same office (even when they are from the same firm).
- Some engagement team members may work partially remotely, mostly remotely, or fully remotely.
- Audit tools and techniques are becoming more data driven.
- Audit documentation and retention methods are increasingly paperless and virtual in keeping with similar changes in company record retention.

In addition to the evolution occurring at accounting firms, the structure of registrants being audited by the accounting firms is also continuing to evolve. For example, registrants are continuing to centralize activities and processes to be applicable to more than one location or business unit (e.g., shared service centers or centralized processing activities). The registrant's organizational structure and information system directly impact the lead auditor's audit plan, including whether the financial information of certain locations or business units may be considered together for purposes of planning and performing audit procedures. For example, a registrant may have three legal entities with similar business characteristics operating in the same geographical location under the same management and using a common system of internal control, including the information system. In these circumstances, the lead auditor may decide to treat these three legal entities as one location or business unit. It is important that the PCAOB's auditing standards are operationalized in an environment in which work structures and the nature of audit evidence will continue to change. Given these considerations, we have observations as follows:

- Proposed AS 1201.10 states, "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." We appreciate the need for documentation between the lead auditor and the other auditors; however, we respectfully resubmit the view expressed in our firm's response to the 2016 and 2017 Releases that requiring changes in the nature, timing, and extent of audit procedures be in writing in all cases seems overly onerous and inconsistent with current practice of how the engagement partner (or engagement team members who assist with fulfilling the engagement partner's responsibility pursuant to proposed AS 1201) would manage communications about necessary changes in work performed by engagement team members. Determining whether changes to audit procedures are necessary and making the necessary communications often involves a collaborative effort between engagement team members and results in direct changes to related working papers (versus a separate document identifying the change in addition to the change in the related working paper). As the lead auditor may have the ability to review working papers of the other auditor, the lead auditor has the ability to determine that changes to audit procedures were appropriately incorporated; therefore, having written acknowledgement seems unnecessary. In addition, technology-enabled audit platforms and communication tools often allow lead auditors and other auditors to communicate and view work electronically and in real time. Therefore, we suggest that the requirement support more flexibility and an iterative collaborative approach. We recommend that the 2021 Proposal state that the lead auditor

determines when and how to communicate changes to the other auditor’s planned audit procedures as well as the need to maintain related documentation.

- Proposed AS 1201.09 states, “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.” As noted above, given that the lead auditor may have the ability to review working papers of the other auditor and technological advances are changing how we perform audits whereby the lead auditor and the other auditors are able to communicate and view work electronically, we recommend the requirement be amended to remove “obtain.” This additional layer of documentation that proposed AS 1201.09 is requiring to be “obtained” by the lead auditor, however not required to be “retained” in the audit documentation, is unnecessary and will result in confusion as to what the lead auditor should do with other auditor audit documentation that they obtain but don’t need/want to keep.
- Proposed AS 1201.11 states, “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” To be consistent with AS 1215.19, we believe modifications to proposed AS 1201.11 are needed, such that the lead auditor should retain the affirmation.

Determining the Other Auditor’s Compliance with Independence and Ethics Requirements

We commend the PCAOB for its responsiveness to our observations raised in our 2017 comment letter with respect to the lead auditor gaining an understanding of the other auditors’ processes for determining compliance with SEC independence requirements and PCAOB independence and ethics requirements, and we offer further suggestions to refine various requirements.

Written Affirmations. Proposed AS 2101.06Db(3) requires the lead auditor to obtain from each other auditor a written affirmation as to whether the other auditor is in compliance with SEC independence requirements and PCAOB independence and ethics requirements (the “independence and ethics requirements”) with respect to the audit client. We are supportive of the addition of the language “with respect to the audit client” in the 2021 Proposal, and in addition, we suggest this wording also be added to proposed AS 2101.06D. However, we believe that additional guidance is needed to specify how broadly (or narrowly) the independence and ethics requirements must be applied by other auditors in their determination of compliance with respect to the audit client. We encourage the PCAOB to consider the International Ethics Standards Board for Accountants’ (IESBA’s) project to revise their International Independence Standards (IIS), specifically *Engagement Team — Group Audits Independence*, and undertake similar efforts to provide clarity on the application of independence and ethics requirements for other auditors. An objective of the IESBA’s project is to revise the IIS so that they are robust, comprehensive, and clear when applied in a group audit context. While the IESBA’s project is currently in the exposure draft development stage, the proposed revisions include guidance on independence considerations applicable to network firms of group auditor firms and component auditor firms outside a group auditor firm’s network. Because many public accounting firms that follow PCAOB standards are also subject to the IIS, we suggest, and are supportive of, PCAOB convergence with the IIS on this matter. Pages 12-13 of the 2021 Release discuss the definition of lead auditor, including “individuals who work under that firm’s direction and control and function as the firm’s employee.” The 2021 Release states the following:

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 under PCAOB standards would be the same as for employees of the lead auditor’s firm who work on the audit.

Recognizing that some of the independence rules apply broadly to all employees in the firm, not only members of the audit engagement team, we believe that additional clarification is needed regarding the independence requirements for the population of individuals who work under the firm’s direction and control and function as the firm’s employees (e.g., temporary contractors or others as described in the 2021 Release) and specifically regarding the above statement in the 2021 Release that the requirements are the same as for employees of the lead auditor’s firm who “work on the audit.” These individuals only function as the firm’s employees for purposes

of the audit engagement(s) on which they work; therefore, we believe that these individuals should only have independence obligations with respect to those specific audit client(s) and not with respect to any other audit clients of the lead auditor's firm. We recommend that clarification be made in proposed AS 2101 to reflect this perspective.

Other Matters

Effective Date. In regard to the effective date considered by the Board, we strongly recommend an effective date for audits with fiscal years beginning no sooner than two years after the approval by the SEC (or for audits of fiscal years beginning three years after the year of SEC approval if that approval occurs in the third or fourth quarter). We believe that public accounting firms will need more than one year to determine the full impacts of the approved adopted amendments and new auditing standard, implement new policies and guidance, develop and facilitate related trainings, and coordinate quality control processes with the firm network, other auditors, and referred-to auditors to ensure effective implementation and compliance. Furthermore, we believe it is important to consider the IAASB's suite of international quality management-related standards that public accounting firms will be adopting in the near term and the significant implementation time and impact to auditor firms that these will have. Specifically, ISQM 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*; ISQM 2, *Engagement Quality Reviews*; and ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*, are all effective in 2022. In addition, similar to the PCAOB, the IAASB is revising its auditing standard related to group audits, including those in which other auditors are used (referred to in the ISAs as "component auditors"). Although it is not yet final, the IAASB's proposed ISA 600 (Revised), *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*, is proposed to be effective for audits of group financial statements for periods beginning on or after December 15, 2023.

Equity Method Investments and Investee Auditors (2021 Release Question #11). We are supportive of the Board's determinations reflected in the 2021 Release related to equity method investments. We note that Page 47 of the 2021 Release states:

*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.** [Emphasis added]*

Proposed AS 2101.06b states, "The auditor should perform the following activities at the beginning of the audit... Determine compliance with independence^{3A} and ethics requirements...." The associated footnote 3A states:

*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. [Emphasis added]*

The reference within the 2021 Release to proposed AS 2101.06b creates confusion as to whether investee auditors are subject to the independence and ethics requirements of proposed AS 2101, especially considering the investee auditor has not been engaged to perform an audit (or audit work) on the audit client of the investor auditor. Footnotes 3 and 5 in Topic 4, Section 4110.5 of the *SEC Division of Corporation Finance's Financial Reporting Manual* (FRM) require the investee auditor to be independent under the SEC and PCAOB requirements when the equity method investee's financial statements are filed to satisfy the requirements of Rule 3-09 of Regulation S-K. We believe the PCAOB, through its inclusion of the wording on Page 47 of the 2021 Release, did

not intend to change current practice as it relates to using an investee auditor's audit report as evidence; however, further clarity is needed if a change in independence considerations was intended.

Specialized Skill or Knowledge. Proposed AS 2101.16, states, “[t]he 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.” There are many examples of when specialized skills may be needed, and we believe existing AS 2101.16 allows for appropriate consideration. If added focus on knowledge of foreign jurisdictions is considered to be needed, we suggest that additional clarity as to when this is needed, and how it should be achieved, be provided in the standard. While page A4-25 of the 2016 Release implies that the reasoning for this change is to assist with gaining an understanding of the qualifications of the other auditor's supervisory personnel (and those who assist the lead auditor with planning or supervision), this addition to the requirement in proposed AS 2101.16 may not appear to achieve this goal, particularly in light of this requirement being applicable to “the auditor” (and therefore not limited to those other auditors who assist the lead auditor with supervisory activities). We recommend this proposed wording in proposed AS 2101.16 be removed.

APPENDIX 2

The comments noted in this section are intended to clarify the auditor performance requirements to avoid misinterpretation (additions in bold and underlined, deletions are struck through).

<p>PCAOB AS 1105.B, Footnote 1</p>	<p>We recommend making the following changes to reflect current practice:</p> <p>In determining whether the report of the investee’s auditor is satisfactory for this purpose, the auditor may consider performing procedures such as making inquiries as to the professional reputation, standing, and independence of the investee’s auditor (under the applicable standards), visiting interacting (e.g., using video conferencing technology or visiting the other auditor) with the investee’s auditor....</p>
<p>PCAOB AS 1201.08, Footnote 15</p>	<p>We recommend making the following changes to create consistency in terminology across the standards:</p> <p>See requirements in AS 2110.49-.53 with respect to discussions among key engagement team members (including those in differing locations which may include engagement team members outside the engagement partner’s firm) regarding risks of material misstatement including the potential for material misstatement due to fraud.</p> <p>We also recommend that the PCAOB make a conforming amendment as follows to AS 2110.50:</p> <p>Key engagement team members (which may include engagement team members outside the engagement partner’s firm) include all engagement team members....</p>
<p>PCAOB AS 1206.07</p>	<p>It is unclear that the circumstances described in proposed AS 1206.07 exist in situations in which the lead auditor originally expected to divide responsibility with the referred-to auditor and has subsequently determined that this is not possible. In addition, when this situation does occur, the proposed AS 1206.07 limits the lead auditor’s performance requirements to only the three options presented. We believe that another alternative is to allow for the lead auditor to identify a different other auditor and appropriately apply the requirements of the 2021 Proposal. Therefore, we recommend making the following changes:</p> <p>In situations in which the lead auditor originally planned to divide responsibility for the audit with an other accounting firm but has subsequently determined that this is not possible 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:</p> <ul style="list-style-type: none"> (a) Plan and perform procedures with respect to the relevant business unit that are necessary for the lead auditor to express an opinion on the company’s financial statements and, if applicable, internal control over financial reporting; or (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 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. (c) Withdraw from the engagement.

	<p><u>Note: The lead auditor may involve an other auditor when planning and performing procedures with respect to the relevant business unit.</u></p>
<p>PCAOB AS 1206.08(b)</p>	<p>Proposed AS 1206.08(b) states that the lead auditor’s report should “[i]dentify 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....” Given that the referred-to auditor’s report is included in the filing, it does not seem necessary to identify them specifically by name in the auditor’s report. We recommend the PCAOB delete this requirement.</p>
<p>PCAOB AS 1215.18 and .19</p>	<p>We recommend making the following changes in paragraphs 18 and 19(e) to improve readability and clarify the meaning. In addition, we recommend the following change to paragraph 19(b) to acknowledge that the form in which the lead auditor obtains the other auditor’s audit documentation may vary:</p> <p>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 [AS 1215] is prepared and retained. Audit documentation supporting the work performed by other offices <u>different from the office issuing the auditor’s report</u> of the firm and other auditors must be retained by or be accessible to...</p> <p>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 offices <u>different from the office issuing the auditor’s report</u> of the firm and other auditors:...</p> <p>b. A list of Significant risks, the auditor’s responses, and the results of the auditor’s related procedures.</p> <p>e. Sufficient information to enable the office issuing the auditor’s report to agree or to reconcile the financial statement amounts audited by other offices <u>different from the office issuing the auditor’s report</u> of the firm and other auditors to the information underlying the consolidated financial statements.</p>
<p>PCAOB AS 1301.10</p>	<p>We recommend making the following changes to acknowledge that the specific names of other auditors and referred-to auditors (e.g., the names of all the people on an other auditor’s engagement team) do not need to be provided but that the name of the firm is acceptable:</p> <p>As part of communicating the overall audit strategy, the auditor should communicate the following matters to the audit committee, if applicable:...</p> <p>d. The names, locations, and planned responsibilities of other auditors that perform audit procedures in the current period audit and of referred-to auditors; and</p> <p><u>Note: When communicating the names of other auditors or referred-to auditors, the auditor may communicate the name of the other auditor’s firm or the referred-to auditor’s firm.</u></p>
<p>PCAOB AS 2101.06b</p>	<p>We recommend making the following changes to improve readability and clarify the meaning:</p> <p>In an audit that involves other auditors, see paragraphs .06D-F of this standard [AS 2101], which describe performing additional procedures <u>that are performed by the lead auditor</u> regarding other auditors’ compliance with independence and ethics requirements. In an audit that involves referred-to auditors, see AS 1206.05-.07.</p>

<p>PCAOB AS 2101.06Ac</p>	<p>We recommend making the following changes to improve readability and clarify the meaning:</p> <p>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:...</p> <p>c. The extent of the <u>lead auditor’s</u> engagement partner’s firm’s supervision of the other auditors’ work 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 <u>lead auditor’s</u> firm’s supervision of a first other auditor and any other auditor that is supervised directly by the <u>lead auditor</u> firm.</p>
<p>PCAOB AS 2101.06D</p>	<p>In order for other auditors to assist the lead auditor in complying with the requirements laid out in proposed AS 2101.06Da-c, the other auditors must first have an understanding of what the relevant independence and ethics requirements and circumstances are. Therefore, we recommend adding the following requirement preceding proposed AS 2101.06Da:</p> <p><u>a. Communicate the relevant independence and ethics requirements that are applicable to the other auditors, given the nature and circumstances of the audit engagement; and</u></p> <p>a.<u>b.</u> 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....</p>
<p>PCAOB AS 2101.06D</p>	<p>We recommend making the following changes to improve readability and clarify the meaning:</p> <p>Note: For the matters described in paragraph .06D, information (including affirmations and descriptions) may be obtained from the other auditor <u>that addresses</u> covering the other auditor’s firm and <u>all the</u> engagement team members who are partners, principals, shareholders, or employees of the firm.</p>
<p>PCAOB AS 2101</p>	<p>Certain requirements are addressed to the lead auditor, other auditor, or referred-to auditor that we believe should instead be addressed to the lead auditor’s firm, other auditor’s firm, or referred-to auditor’s firm. Recognizing that the respective firm is included in the lead auditor, other auditor, or referred-to auditor as defined in proposed AS 2101, we believe that certain requirements would apply specifically to the firm and not the engagement partner or other engagement team members of the lead auditor, other auditor, or referred-to auditor. Therefore, we recommend making the following changes to improve readability and clarify the meaning:</p> <ul style="list-style-type: none"> • Proposed AS 2101.06Db.(1): “A written affirmation as to whether the other auditor’s <u>firm</u> 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;” • Proposed AS 2101.06G: “In an audit that involves an other auditor that plays a substantial role in the preparation or furnishing of the lead

	<p>auditor’s report, the lead auditor may use the work of the other auditor only if the other auditor’s firm is registered with the PCAOB.”</p> <ul style="list-style-type: none"> Proposed AS 2101.06G footnote 4G: “See also AS 1206 for requirements for the lead auditor relating to the registration status of a referred-to auditor’s firm.” Proposed AS 2101.A5a.(1): “A partner, principal, shareholder, or employee of the lead auditor’s firm or”
<p>PCAOB AS 2101.06Db (3)</p>	<p>We recommend making the following changes to enhance the other auditor’s requirement with respect to instances of noncompliance with SEC independence requirements and PCAOB independence and ethics requirements:</p> <p>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 <u>and the other auditor’s conclusion regarding whether it is capable of exercising objective and impartial judgment on all issues encompassed within the other auditor’s work.</u></p> <p>Furthermore, after AS 2101.06Db we recommend adding a requirement for the lead auditor to assess any instances of noncompliance reported by the other auditor:</p> <p><u>Assess any instances of non-compliance reported by the other auditor and the impact of such non-compliance on the other auditor’s objectivity and impartiality and consequently any impact on the lead auditor’s ability to use the work of the other auditor.</u></p>
<p>PCAOB AS 2101.A2</p>	<p>Proposed AS 2101 defines the term “engagement partner” for purposes of such standard, and we believe that the intention of the PCAOB is that the engagement partner is from the lead auditor’s firm. However, there could also be an engagement partner on the other auditor’s engagement team. We believe the PCAOB’s intent is that when “engagement partner” is used in standards other than AS 2101 (e.g., AS 1015, AS 1201, AS 1220, AS 2110, AS 2810), it also is intended to mean the engagement partner of the other auditor’s engagement team. We recommend making the following changes to the definition of engagement partner in proposed AS 2101 to clarify the meaning of engagement partner in such standard:</p> <p>Engagement partner — The member of the lead auditor engagement team with primary responsibility for the audit.</p> <p>If the PCAOB does not intend the term engagement partner as used in standards other than proposed AS 2101 to also include an engagement partner from the other auditor’s engagement team, we recommend clarifying this in the other standards (including in those standards that refer back to proposed AS 2101 for the definition). In addition, we specifically note that proposed AS 2110.50 may need to clarify that use of engagement partner refers to the engagement partner from the lead auditor’s firm.</p>
<p>PCAOB AS 2101.A3</p>	<p>Pertaining to the definition of “engagement team,” page A4-8 of the 2016 Release discussed that neither the proposed definition of “engagement team” nor any of the amendments in the proposal would affect the applicability of the independence and ethics requirements of the Board of the SEC to audits involving other auditors and that the Board’s proposal would not change the applicability or meaning of engagement team in the context of the PCAOB’s or SEC’s</p>

	<p>independence rules. The 2016 Release contained footnote 10 on page A4-8, which we recommend including as a footnote to proposed AS 2101.A3:</p> <p><u>The individuals covered by the Board’s definition of “engagement team” are also covered by the definition of “audit engagement team” in the SEC’s independence rules. See Rule 2-01(f)(7)(i) of Regulation S-X, 17 CFR 210.2-01(f)(7)(i). The definition in SEC Rule 2-01(f)(7)(i) also covers certain individuals who are not covered by the Board’s proposed definition of “engagement team,” such as the engagement quality reviewer.</u></p>
<p>PCAOB AS 2101.A3a(2)</p>	<p>We recommend making the following changes to improve readability and clarify the meaning, given that the auditor is responsible for obtaining audit evidence (not the firm):</p> <p>Specialists who (i) are employed by the lead auditor or an other auditor participating in the audit and (ii) assist their firm <u>the lead auditor or an other auditor</u> in obtaining or evaluating audit evidence with respect to a relevant assertion of a significant account or disclosure.</p>
<p>PCAOB AS 2101.A5</p>	<p>We recommend making the following changes to improve readability and clarify the meaning:</p> <p>Other auditor⁸ —</p> <p>a. A member of the engagement team who is not:</p> <p>(1) A partner, principal, shareholder, or employee of the lead auditor’s <u>firm</u> or</p> <p>(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</p> <p>b. A public accounting firm, if any, of which such <u>member of the</u> engagement team member is a partner, principal, shareholder, or employee.</p> <p><u>⁸ The term other auditor is used to refer to a member of the engagement team as described in paragraph A.5.a of AS 2101 or the other auditor’s firm as described in paragraph A.5.b of AS 2101.</u></p>
<p>PCAOB AS 2601.19</p>	<p>The proposed amendment made to proposed AS 2601.19 results in replacing wording that stated “the user auditor should give consideration to the guidance in proposed AS 1205.12” with “the user auditor should consider performing one or more of the following procedures.” Appendix 4 of the 2016 Proposal states that the “proposed conforming amendments are not intended to change the meaning of existing requirements.” However, we believe the change to proposed AS 2601.19 does result in a change to the meaning as well as the related auditor performance requirement. The extant text to “give consideration to the guidance in proposed AS 1205.12” merely requires the user auditor to refer to and contemplate factors in proposed AS 1205.12 when considering whether the service auditor’s report is sufficient to meet his or her objectives; such guidance was not specifically intended for user auditors. By contrast, the proposed text to “consider performing one or more of the following procedures” specifically requires the user auditor to contemplate taking specific actions (one or all three of the proposed procedures) as part of considering whether the service auditor’s report is sufficient to meet his or her objectives.</p> <p>Therefore, we recommend the PCAOB align the modification closer to the extant text as follows:</p>

	<p>In considering whether the service auditor's report is sufficient to meet his or her objectives, the user auditor may give consideration to should consider performing one or more of the following procedures:</p> <ul style="list-style-type: none"> • Visiting the service auditor and discussing the audit procedures followed and results thereof. • Reviewing the audit programs of the service auditor. In some cases, it may be appropriate to issue instructions to the service auditor as to the scope of the audit work. • Reviewing additional audit documentation of the service auditor.
<p>PCAOB AS 3305.31c., Footnote 40</p>	<p>We recommend making the following changes to clarify that the lead auditor (as stated in proposed AS 1206) divides responsibility:</p> <p>AS 1206, <i>Dividing Responsibility for the Audit with Another Accounting Firm</i>, establishes requirements for situations in which the lead auditor of the consolidated financial statements ("lead auditor") makes reference in the auditor's report to the report of another accounting firm that audited the financial statements of one or more of the company's business units. (<i>See also</i> paragraphs .B2 and .B3 of AS 2101, <i>Audit Planning</i>, which establish requirements regarding serving as the lead auditor.)</p>



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30 November 2021

**Re: Supplemental Request for Comment: Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Accounting Firm
PCAOB Rulemaking Docket Matter No. 042**

Dear Ms. Brown:

Ernst & Young LLP is pleased to submit these comments to the Public Company Accounting Oversight Board (PCAOB or Board) on the Supplemental Request for Comment: Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Accounting Firm.

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

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

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

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



Lead auditor determination

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

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

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

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

Risk of material misstatement

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

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

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

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

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

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

- b. With respect to the work requested to be performed:
- (1) Significant matters affecting the identified risks of material misstatement to the consolidated financial statements that are applicable to the location or business unit as required by AS 2110.49-53;
 - (2) Matters that are relevant to the other auditor's design or performance of risk assessment procedures for purposes of the audit of the consolidated financial statements;
 - (3) Tolerable misstatement; and
 - (4) The amount (if determined) below which misstatements are clearly trivial and do not need to be accumulated.

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

Effective date

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

Other matters

Definition of lead auditor

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

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



Definition of investee auditor

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

Definition of other auditor and multi-tier auditor

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

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

* * * * *

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

Very truly yours,

Copy to:

PCAOB

Duane M. DesParte, Acting Chairman
Christina Ho, Board Member
Kara Stein, Board Member
Barbara Vanich, Acting Chief Auditor

SEC

Gary Gensler, Chairman
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Via Email to comments@pcaobus.org

Re: PCAOB Rulemaking Docket Matter No. 042, *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Accounting Firm*

Dear Board Members and Staff:

Grant Thornton LLP appreciates the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or Board) Second Supplemental Request for Comment (2021 SRC) on the *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Accounting Firm*. We respectfully submit our comments and responses to certain of the questions posed in the 2021 SRC for the Board's consideration.

We appreciate the Board's continued work in strengthening the requirements that apply to audits involving other auditors. We believe this is an important area in furthering overall audit quality, particularly since the use of other auditors in various capacities continues to become more prevalent. We also believe that COVID-19 changed how firms use and interact with other auditors, which we discuss in more detail below. Providing principles-based requirements with regard to using the work of other auditors is essential in order to promote audit quality and appropriate participation by the lead auditor. We believe the suggested revisions provided below will help enhance the clarity and feasibility of the proposed requirements while maintaining a principles-based approach and bearing in mind the changes to the profession that have occurred over the last couple of years.



We also encourage the Board to consider a holistic view of this topic. We believe that the definitions and requirements proposed in the 2021 SRC could have considerable implications for the application of independence requirements as well as firms' systems of quality control. Without considering the potential impact of the proposed definitions on other areas of the PCAOB's rules and standards as well as on future standard setting, there may be certain unintended consequences. We elaborate on this matter in more detail below.

Responses to certain questions posed in the 2021 SRC

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

The most impactful changes to auditor practices related to the use of other auditors resulted from operating in the COVID-19 environment. Operating in a largely remote environment, auditors had to effectively leverage the use of technology in order to appropriately fulfill their responsibilities under the existing requirements. The use of technology affected the physical locations where auditors worked and the ways in which engagement teams and other auditors interacted with each other and with client management. We anticipate that remote work arrangements will continue into the future for both auditors and clients given the relative popularity of the concept and the efficiencies gained.

Question 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?

We found the proposed revisions to the definitions to be helpful. We offer the following observations that may further enhance the practicability or application of the definitions.

Considerations related to secondees

First, we note that proposed footnote 5, which relates to the second note under paragraph .A4, states that "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...." We appreciate this proposed addition and believe it was responsive to concerns raised in comment letters to the PCAOB's 2017 Supplemental Request for Comment on this topic (2017 SRC).

However, as discussed in our response to Question 1 above, the landscape of public accounting has changed considerably over the last two years. Firms have encountered a variety of logistical challenges related to bringing secondees into their country to physically work. As a result, many firms have adapted their programs to enable remote arrangements. For example, an individual seconded to work with a firm located in the United States might remain physically located in their home country. Therefore, we believe the physical location of the individual should not be a determining factor for whether an individual meets the definition of secondee, as used



in the proposed amendments. As such, we recommend the footnote be revised as follows.

For this purpose, the term “seconded” 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, **for at least three consecutive months, for the registered public accounting firm issuing the auditor’s report in another country** with respect to entities in that other country (and not performing more than de minimus audit procedures over the term of the secondment in relation to entities in the country of his or her employer).

We recognize that our suggested revisions have implications for the staff guidance on this topic provided by the Board related to Form AP. We encourage the Board to revise the language and amend the Form AP staff guidance accordingly to make them consistent.

Considerations related to independence and the system of quality control

Additionally, we ask whether the Board has considered the potential ramifications of the proposed changes to the definition of “engagement team” on the application of independence requirements. The PCAOB’s Ethics & Independence rules, as well as the AICPA’s Code of Professional Conduct, do not explicitly provide guidance on how to apply independence rules to engagement team members that are employed or engaged by other accounting firms, as these independence rules were not written with such circumstances in mind. There is significant discussion on this topic by the International Ethics Standards Board for Accountants (IESBA) as IESBA contemplates how to clarify this concept in their independence rules, and similar discussions are expected to occur within the AICPA’s Professional Ethics Executive Committee. We encourage the Board to consider IESBA’s deliberations and ultimate conclusions and to provide guidance to the PCAOB’s requirements. We believe that PCAOB guidance will be necessary for auditors to fully understand and apply the proposed requirements and to meet PCAOB expectations in light of the new definition.

There are also implications for International Standard on Quality Management (ISQM) 1, *Quality Management for Firms That Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*, which the Board may use as a starting point for revisions to its quality control standards, as described in the PCAOB’s 2019 Concept Release, “Potential Approach to Revisions to PCAOB Quality Control Standards.” Unintended practical challenges could arise when firms apply the quality management processes with individuals who are identified as members of the engagement team but are employed by other accounting firms that are outside the control of the accounting firm issuing the auditor’s report. Clarification might be necessary, particularly with respect to requirements related to engagement team members as well as service providers, including the application of the requirements to referred-to auditors. Again, enhanced guidance would enable auditors to appropriately understand and apply the requirements.



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?

We support the addition of “c” to paragraph .06A of AS 2101. We believe this content is reasonable and will assist auditors with their determination of lead auditor. However, we are concerned that this proposed requirement is too prescriptive for practical application, since the three proposed criteria are not necessarily the only appropriate considerations in such a determination. We recommend the following edit to the lead-in to make the requirement more principles-based by acknowledging that there might be other relevant factors for the auditor to consider:

... In making this determination, the engagement partner should take into account, **alone or in combination**, the following **factors, as well as other factors specific to the audit** ~~in combination~~....

We also encourage the Board to consider whether the descriptor “significance” would be more appropriate than “importance” in .06A(a). We believe the term “significance” is more understandable in the context of considering quantitative and qualitative factors. In addition, because the determination of the lead auditor is typically made during the acceptance or continuance process, we recommend clarifying .06A(b) as follows, since the risks of material misstatement may not be identified and assessed at this stage of the audit: “the risks of material misstatement **that may be** associated with...”

Similarly, we recommend adding “planned” to .06A(c) so that it reads “the **planned** extent of the engagement partner’s firm’s supervision....” Considering the context in which this requirement is being executed, it is possible that the lead auditor might adjust the extent of supervision once the engagement is underway.

Question 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?

We found the proposed changes helpful and appreciate that the Board was responsive to some of the practical challenges highlighted in comment letters to the 2017 SRC.

We strongly support obtaining a written affirmation from the other auditor and believe clarity in the requirement is essential in making such requirement operational. With regard to paragraph .06D(b)(1), we note that accounting firms generally assess the effectiveness of their systems of quality control on an annual basis (and that this is what will be required going forward under ISQM 1). We do not believe it is the Board’s intention to put the other auditor engagement team members in a position to make their own conclusion about their firm’s quality control at a point in time relative to a particular engagement. It could be confusing and cost prohibitive to establish a requirement that indicates a continual assessment of a firm’s system of quality control



is necessary. Therefore, we recommend the following edits in order to be clearer on what the other auditor is affirming for a particular engagement.

- (1) a written affirmation as to whether the other auditor has policies and procedures that **are intended to** provide reasonable assurance that the other auditor maintains compliance with SEC independence requirements and PCAOB independence and ethics requirements

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

We generally support the proposed revisions, which include obtaining the written affirmation from the other auditor. We believe the proposed revisions make these requirements more operational. The requirement could be further enhanced if the Board inserts a note after paragraph .06H that indicates the lead auditor's own experience working with the other auditor is relevant to the lead auditor's understanding of the other auditor's knowledge, skill, and ability. We believe that it would be helpful to include this guidance, as acknowledged on page 27 of the 2021 SRC and on page 16 of the 2017 SRC, in the standard itself in order for auditors to better understand and apply the proposed requirements with regard to the knowledge, skill, and ability of other auditors.

Question 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?

We support the objective of clarifying the lead auditor's responsibilities with respect to the supervision of work performed by other auditors. Further, we agree with the proposed revisions to paragraph .08 and the addition of paragraph .11. Such written communications at the beginning and end of the other auditor's work are important in setting appropriate expectations for the other auditor and in evaluating whether and how the other auditor met such expectations. Nevertheless, we are concerned about potential operational challenges with the proposed requirements listed in paragraphs .09 and .10.

We believe the requirement for the lead auditor to obtain and review a written description of the audit procedures to be performed by the other auditor is overly prescriptive and would be burdensome in practice, especially when the other auditor is performing an audit (as opposed to procedures over certain significant accounts or disclosures). An audit involves an iterative process of risk assessment and response and, therefore, procedures can evolve over the course of the audit. The communications between the lead auditor and the other auditor are also iterative. Thus, it could be administratively burdensome or time and cost prohibitive to fulfill these requirements as currently proposed, especially on large, multinational



engagements. We believe the requirements can be more principles-based and better reflect the changes in how auditors communicate with each other in light of the technological advances in communication tools. Such advances provide better opportunities for more real-time communication, which is not reflected in the proposed requirements. Communication of planned procedures and related changes could be accomplished through video conference and screen-sharing whereby the lead auditor might not necessarily possess a "written description" of the audit procedures or changes to such procedures. We encourage the Board to revise paragraphs .09 and .10 to make them more principles-based and to reflect the recent innovations in effective communication tools.

Finally, we recommend clarifying paragraph .12 with regard to the minimum documentation requirement, which is currently connected to AS 1215.19. The requirements of AS 1215 are based on a complete audit. When the lead auditor directs the other auditor only to perform procedures over certain significant accounts or disclosures, all components of AS 1215.19 might not be relevant. For example, a management representation letter is only required when the other auditor performs a complete audit and issues an external auditor's report. We ask the Board to consider clarifying proposed paragraph .12 to acknowledge that the documentation required would be commensurate with the nature and extent of audit work performed by the other auditor.

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?

The modifications appear reasonable and clear. We continue to believe it is essential to retain AS 1206 and the ability to divide responsibility for the audit. We also appreciate the Board providing illustrative report examples, which will help promote consistency among auditor's reports.

We do believe that the proposed requirement in paragraph .08(b) is unnecessary, however. Currently, the Form AP rules require the disclosure of the name and city of any referred-to auditors. We believe it is duplicative to require the name of the referred-to auditor in the auditor's report itself. We encourage the Board to remove this requirement due to its existence in the Form AP requirements.

In addition, we believe it would be beneficial to clarify, in both AS 1206 and AS 1201, that the lead auditor may use completed audit work. When an other auditor is also performing or has completed an audit of component or subsidiary financial statements, the lead auditor may be able to use audit work performed on those financial statements, provided the lead auditor is satisfied that such work is appropriate for purposes of their audit. We encourage the Board to incorporate this into each standard to accommodate the various situations that could arise in practice, including those with respect to the timing of multi-tiered audit engagements.

Effective date

As we conveyed in our comment letter to the 2017 SRC, we continue to believe that audit firms will need sufficient time to develop and implement policies and quality control processes and to provide adequate communication to their network firms.



Since planning for large, international engagements begins very early in the audit process, we strongly recommend making the proposed standard and amendments effective for audits of fiscal years beginning two years after approval by the SEC or, if SEC approval occurs in the third or fourth quarter, fiscal years beginning three years after the year of SEC approval. We also believe this will provide the Board with appropriate time to consider the independence and quality control implications discussed throughout this letter and to respond appropriately by making additional revisions to the proposed requirements or to other PCAOB rules or standards, if necessary.

We would be pleased to discuss our comments with you. If you have any questions, please contact Jeff Hughes, National Managing Partner of Audit Quality and Risk, at 404-475-0130 or Jeff.Hughes@us.gt.com.

Sincerely,

/s/ Grant Thornton LLP



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

Issued 30 November 2021

ICAEW welcomes the opportunity to comment on the *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* published by Public Company Accounting Oversight Board (PCAOB) on 28 September 2021, a copy of which is available from this [link](#).

ICAEW welcomes the PCAOB's proposals and looks forward to the finalisation of the relevant standards.

ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of its vision of a world of strong economies, ICAEW works with governments, regulators and businesses and it leads, connects, supports and regulates more than 157,800 chartered accountant members in over 147 countries. ICAEW members work in all types of private and public organisations, including public practice firms, and are trained to provide clarity and rigour and apply the highest professional, technical and ethical standards.

This response of 30 November 2021 has been prepared by the ICAEW Audit and Assurance Faculty. Recognised internationally as a leading authority and source of expertise on audit and assurance issues, the faculty is responsible for audit and assurance submissions on behalf of ICAEW. The faculty has around 7,500 members drawn from practising firms and organisations of all sizes in the private and public sectors.

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KEY POINTS

1. ICAEW welcomes the PCAOB's proposals and looks forward to the finalisation of the relevant standards.

ANSWERS TO SPECIFIC QUESTIONS

Questions 1 and 2 *In recent years, have there been changes to auditor practices related to the use of other auditors? And:*

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?

2. Yes, there have been significant changes to auditor practices related to the use of other auditors in recent years. These relate to:
 - changes in the use of technology by both auditors and audited entities
 - increasing complexity in group structures
 - greater consistency in the application of audit procedures arising from the development and extension in the reach of global audit methodologies
 - a movement away from full scope audits performed at component level towards work on specific balances, and the specification of procedures to be performed.
3. The use of **shared service centres** has led to a change in the nature of the work performed by auditors, the distribution of that work among auditors, and communications between auditors, particularly in relation to the work on IT general controls required by ISA 315. Other auditors increasingly require work to be performed and information to be provided by lead auditors for the purposes of other audits, just as lead auditors require work of and information from other auditors. The situation sometimes becomes circular. The other auditors cannot complete their work without assurances from the lead auditor and vice versa. Similar issues arise where the other entity's systems are managed by head offices. Lead and other auditors have an increasing need to see and understand the planned audit procedures to be performed by multiple other auditors, and the results thereof.
4. Highly **complex group structures** generally, particularly very large scale multi-locational audits, and highly structured groups with many equity method investees, give rise to an increased risk of inconsistencies in group audit instructions, the work performed, and reporting.
5. One area particularly worthy of note is the increasing complexity of group structures and the ever-growing amount of data flowing through systems and applications, often cross-border. This has greatly increased the challenge to group and other auditors in relation to:
 - understanding data flows
 - developing appropriate approaches to obtain audit evidence relating to the accuracy and completeness of information produced by the entity and information used in the control
 - assigning responsibilities for testing this data.
6. More time is required for planning, more judgement required in determining the work to be performed and in evaluating the results obtained. More robust and clearer two-way communications generally are needed and the proposed revisions help facilitate communications.

ICAEW REPRESENTATION 113/21 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

7. EU mandatory **auditor rotation requirements** have given rise to issues relating to auditors within and outside networks. There are now more networks than there used to be and while auditing standards do not permit distinctions to be made between network and non-network other auditors, the general trend, as a result of rotation requirements, is for auditors from different networks to be involved in group audits.
8. Technology has facilitated better **access to other auditor working papers**, but access remains a perennial problem exacerbated by the pandemic and EU GDPR and equivalent data protection requirements that prevent the transfer of papers across borders, particularly as they relate to statutory audit requirements. Previously, some of these problems have been overcome by group auditors travelling to inspect working papers, but travel restrictions look set to hamper such inspections for some time to come. Alternatives will need to be found.

Question 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?

9. Concern has been expressed about the A1-15 definition of ‘lead auditor’. The definition as drafted appears to be closely aligned with the physical location of the office issuing the audit opinion.
10. In practice, audit teams are often assembled from many different jurisdictions. We acknowledge that footnote 5 relating to secondees attempts to deal with this. The addition appears to reflect the Form AP disclosure rules. However, it does not go far enough.
11. The lead auditor team includes individuals who work under that firm’s direction and control and function as the firm’s employees, including secondees who must spend at least 3 months in the offices of the firm issuing the auditor’s report.
12. Many firms are no different to the businesses that they audit to the extent that highly complex IT systems mean that essential audit work is necessarily carried out by teams with specialist skills on a remote basis, often offshore. Some of these highly skilled teams can clearly be seen to be working under the firms’ direction and control because they are legally employees of the ‘home’ firm and work closely with audit teams despite, being physically located elsewhere on a permanent basis. However, where those teams are not legally employees of the home firm, for purely administrative reasons, we are concerned that that audit inspectors may seek to construe the note to paragraph .A4 too narrowly, and to rule that such teams are not under the firm’s direction and control, because they are neither employees nor secondees, as currently defined, despite the fact that in substance, they are under the firm’s direction and control. Consistency in the placement of employees on the form AP is important.
13. These working arrangements seem likely to become more, not less prevalent, post-pandemic, and we believe that the note to .A4 should make it clearer than it does that individuals who are neither legally employees of the firm, nor secondees as defined, may in fact be under the direction and control of the firm. The inclusion in the note to .A4 of factors that might indicate working under the direction and control the registered public accounting firm issuing the auditor’s report would assist with consistency of interpretation of the definition of lead auditor.

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?

14. We are content with the addition of paragraph c to paragraph .06A on page A1-4 which clarifies that the lead auditor is only required to review the work of first other auditors.

Question 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?

15. The 2017 proposals required the lead auditor to gain an understanding of each other auditors’ *process* for determining compliance with, and experience in applying, the independence and ethics requirements.
16. The proposed amendment to paragraph .06D changes this to require lead auditors to understand the other auditor’s *knowledge* and experience, as well as a new requirement for the lead auditor to obtain and review a written affirmation as to whether other auditors have *policies and procedures* that provide reasonable assurance that they maintain compliance with independence and ethics requirements
17. It is unclear how far these amendments are intended to go, and the extent of understanding required outwith the written confirmation. Consistency of interpretation would be improved with additional guidance as to the nature and extent of procedures to gain an understanding of the knowledge and experience of the other auditor contemplated by the requirement. Similar considerations apply to the following question.

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

18. This proposal is to require the lead auditor to obtain a written affirmation from other auditors that their personnel possess the knowledge, skill, and ability to perform the audit tasks assigned to them. Again, it replaces a proposal for auditors to obtain an understanding of process and again, it is unclear how far this amendment is intended to go, and the extent of understanding obtained outwith the written confirmation, although the requirements appear similar to those in AS 1210.03.

Question 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?

19. The proposed amendments in paragraph .11 on page A1-21 would require lead auditors to obtain and review a written affirmation as to whether other auditors have performed the work in accordance with instructions provided, including the use of applicable PCAOB standards.
20. Paragraph .08 covers the group audit instructions, the other auditor’s written description of the procedures to be performed, and the need for lead auditors to specify the level of detail in the information required. It is not clear from these requirements whether the lead auditor is looking for statements about what will and has been done, the findings, the conclusions reached, or all three. Memoranda differ across firms, and the quality of content varies. Further emphasis in para .09 with regards to the nature, timing and extent of these supervisory procedures may assist with consistency of interpretation and practice.

ICAEW REPRESENTATION 113/21 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

21. Firms often receive information that describes procedures performed as being in accordance with the firm’s methodology, rather than specifically with PCAOB, IAASB or other standards. The requirement to make a specific statement regarding compliance with PCAOB standards is therefore welcome.

Question 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?

22. These amendments are intended to avoid unnecessary duplication of the first other auditor’s review of other auditors’ work by lead auditors.
23. Instead of requiring lead auditors to review a ‘summary memorandum’, the proposed amendments would require that lead auditors to take into account the first other auditors’ review of second other auditors’ work in determining the extent of their own review, if any, of second other auditors’ work.
24. Lead auditors may request first other auditors to both (i) obtain, review, and retain audit documentation related to second other auditors’ work and (ii) incorporate the information in that documentation in first other auditor documentation provided to lead auditors.
25. We understand this to mean that it is no longer proposed that lead auditors should ‘ignore’ the ‘firm in the middle’. This is welcome. Lead auditors do not generally need to re-perform the work performed by any other auditors, or re-supervise the work performed by second other auditors. However, there are circumstances in which they might need to, such as where there are doubts about whether the other auditors have performed the required work adequately.
26. Paragraph .14 on page A1-23 states that lead auditors may seek the assistance of first other auditors in performing this work. This is the right approach, because lead auditors need to have confidence that the work performed by second other auditors, and the supervision of those auditors, are adequate.

Question 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?

27. In multi-tiered audits we believe that provided the requirements relating to supervisory procedures dealt with in question 8, above, have been satisfactorily dealt with, the proposed revisions relating to the sufficiency determination and the permission to seek assistance referred to in this question are appropriate.

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?

28. The modifications in the proposed new standard on divided responsibility do not appear to make significant substantive changes. However, there is no guidance for the referred-to

auditor in respect of their communications with the audit committee of the company audited by the lead auditor, and in particular the circumstances under which they should make such direct communications. We understand that the referred-to auditor is not engaged as auditor of the company audited by the lead auditor, but the absence of any line of communication could be problematic, particularly in the context of equity method investees.

Question 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?

29. While we are content with the proposed amendments to AS 1105.B1, the proposals do not adequately address the nature and extent of work to be performed by lead auditors either in cooperation with, or independently of equity method investee auditors. This is an increasingly important area. We do not understand why this section has not been updated to align it with other requirements. B1 only refers to 'reputation' rather than the broader 'knowledge, skill and ability of investee auditors.'
30. Non-coterminous year ends are a common problem. A variety of approaches are used in practice, including the performance of supplementary agreed-upon-procedures by the other auditors, lead auditor access to the investee entity to permit them to perform their own procedures, and divided responsibility. However, divided responsibility is often an unsatisfactory solution and, by definition, access of any sort and the right to instruct other auditors is not guaranteed in these situations. There is a lack of clarity about the nature and extent of work to be performed by lead auditors, even where other auditors and investee companies co-operate, particularly in the area of lead auditor work on the competence, independence and oversight of investee auditors.

Question 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?

31. The amendments do not appear to add any incremental challenges associated with the use of other auditors.



November 30, 2021

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 042 (Second Supplemental Request for Comment)

Dear Board Members:

The Audit and Assurance Services Committee of the Illinois CPA Society (“Committee”) is pleased to comment on the PCAOB’s 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* (Docket Matter No. 042), dated September 28, 2021. The organization and operating procedures of the Committee are reflected in the attached Appendix A to this letter. These comments and recommendations represent the position of the Illinois CPA Society rather than any members of the Committee or of the organizations with which such members are associated.

GENERAL COMMENTS:

As a Committee, we agree with efforts made by the PCAOB and believe the additional proposed amendments, as well as the modifications, are needed to help drive audit quality. We continue to support the Board’s initiative to further strengthen audit quality and investor protection with respect to audits that involve other auditors and referred-to auditors.

Question 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?

Response:

Due to the recent increase in working remotely, although the Committee would encourage the lead auditor to have in person meetings with other auditor(s), consider adding guidance that the lead auditor could use remote access enabling technology as an alternative way to supervise and review the work of the other auditor(s).

The Committee appreciates the opportunity to express its opinion on this matter. We would be pleased to discuss our comments in greater detail if requested.

Genevra D. Knight, CPA
Chair, Audit and Assurance Services Committee

Michael Ploskonka, CPA
Vice Chair, Audit and Assurance Services Committee



ILLINOIS CPA SOCIETY

APPENDIX A

AUDIT AND ASSURANCE SERVICES COMMITTEE
ORGANIZATION AND OPERATING PROCEDURES
2021 – 2022

The Audit and Assurance Services Committee of the Illinois CPA Society (Committee) is composed of the following technically qualified, experienced members. The Committee seeks representation from members within industry, education and public practice. These members have Committee service ranging from newly appointed to almost 20 years. The Committee is an appointed senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of audit and attestation standards. The Committee's comments reflect solely the views of the Committee, and do not purport to represent the views of their business affiliations.

The Committee usually operates by assigning Subcommittees of its members to study and discuss fully exposure documents proposing additions to or revisions of audit and attestation standards. The Subcommittee develops a proposed response that is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times includes a minority viewpoint. Current members of the Committee and their business affiliations are as follows:

Public Accounting Firms:**National:**

Scott Cosentine, CPA
Timothy Delany, CPA
Jennifer E. Deloy, CPA
James J. Gerace, CPA
Michael R. Hartley, CPA
James R. Javorcic, CPA
Jon Roberts, CPA
Amber Sarb, CPA
Elizabeth J. Sloan, CPA
Richard D. Spiegel, CPA
Meredith Vogel, CPA

Ashland Partners & Company LLP
RSM US LLP
Marcum LLP
BDO USA, LLP
Crowe LLP
Mayer Hoffman McCann P.C.
BDO USA, LLP
RSM US LLP
Grant Thornton LLP
Wipfli LLP
Grant Thornton LLP

Regional:

Emily Hoaglund, CPA
Genevra D. Knight, CPA
Michael Ploskonka, CPA
Timothy Van Cott, CPA

CDH, P.C.
Porte Brown LLC
Selden Fox, Ltd.
Miller Cooper & Co., Ltd.

Local:

Arthur Gunn, CPA
Lorena C. Johnson, CPA
Mary Laidman, CPA
Carmen F. Mugnolo, CPA
Jodi Seelye, CPA

Arthur S. Gunn, Ltd.
CJBS LLC
DiGiovine, Hnilo, Jordan & Johnson, Ltd.
Mugnolo & Associates, Ltd.
Mueller & Company LLP

Industry/Consulting:

Sean Kruskol, CPA

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November 30, 2021

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
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PCAOB Rulemaking Docket Matter No. 042: *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*

Dear Office of the Secretary:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or the Board) Release No. 2021-005, *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* (referred to as the proposed amendments and the proposed standard, respectively, and collectively as the Second Supplemental Request for Comment).

The Board has requested public comment on the Second Supplemental Request for Comment that is intended to improve audit quality and investor protection through enhancements to the current requirements related to the lead auditor's responsibilities concerning 1) the supervision of other auditors and 2) referred-to auditors. Overall, we continue to support the Board's initiative to further strengthen audit quality and investor protection with respect to audits that involve other auditors and referred-to auditors.

Overview

KPMG commends the PCAOB for its efforts to acknowledge and respond to the comments it received in relation to Release No. 2017-005, *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* (referred to as the Supplemental Request for Comment), through its Second Supplemental Request for Comment. We agree with the Board's goal to provide a more uniform, risk-based approach to supervision in audits that involve other auditors and the Board's approach to achieve this goal through further considerations and amendments to AS 2101, *Audit Planning*, and AS 1201, *Supervision of the Audit Engagement*.

The Second Supplemental Request for Comment includes certain enhancements that address implementation challenges with respect to the other auditor's compliance with independence and ethics requirements. In our view, these enhancements will significantly improve the lead auditor's ability to respond to the diverse range of facts and circumstances that may arise in audits involving other auditors without sacrificing audit quality. Further, we commend the PCAOB for the re-organization of the proposed amendments from the Appendices to the body of the standards, which improves usability and clarity. Overall, we encourage the Board to continue its momentum on this important project and we look forward to its completion.



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We offer the following comments on the proposed amendments where further clarification and guidance may be warranted.

Definition of 'lead auditor'

We observe that the definition of 'lead auditor' in paragraph .A4 of AS 2101 in the Second Supplemental Request for Comment includes the following (certain portions of the definition are underlined for emphasis):

.A4 Lead auditor –

- a. The registered public accounting firm 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.

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 secondees⁵ 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.

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).

As raised in our 2017 comment letter,¹ we appreciate the addition of the Note clarifying the consideration of secondees. Further, we acknowledge that the definition of secondees added as footnote 5 of AS 2101.A4 is consistent with the definition provided by the PCAOB in Form AP staff guidance.²

However, we have concerns that the definition of secondees may be too prescriptive, particularly regarding the physical location of the secondees. For example, during the COVID-19 pandemic, certain

¹ KPMG comment letter on PCAOB Rulemaking Docket Matter No. 042, November 15, 2017.

² Staff Guidance – Form AP, Auditor Reporting of Certain Audit Participants and Related Voluntary Audit Report Disclosure Under AS 3101, Reports on Audited Financial Statements, February 16, 2017, page 9.



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travel restrictions limited or eliminated the ability of secondees to physically relocate to another country. Further, remote working arrangements, where employees have flexibility in where they physically work, have increased substantially as a result of the pandemic and are expected to continue into the future. As a result, the physical location of a secondee may not always align with the geographical location of the office of the registered public accounting firm issuing the auditors' report. Nonetheless, such secondees work under that firm's direction and control and function as the firm's employees in a remote working environment. Therefore, we question whether the physical location is a necessary attribute when considering whether a secondee would meet the definition of lead auditor.

Additionally, we note that employees of a shared service center – an entity affiliated with one or more firms that provides certain audit-related services to the firm(s)³ – were discussed as part of the definition of lead auditor in the Supplemental Request for Comment, but are not mentioned in the Second Supplemental Request for Comment. Similar to secondees, the employees of a shared service center may work under the direction and control and function as employees of the registered public accounting firm issuing the auditors' report. Given the continued increase in the use of shared service centers in practice and consistent with our 2017 comment letter, we believe that employees of shared service centers are an important concept to incorporate in the final amendments.

Overall, we believe the existing definition in paragraph .A4b(1) of AS 2101, specifically "individuals who work under that firm's direction and control and function as the firm's employees", would be sufficient to allow auditors to make a principle-based assessment that best reflects the substance of the arrangements. We believe a principle-based approach to the proposed amendments will capture the evolving nature of how and where work is performed by auditors in the future. Therefore, we recommend the Board consider including secondees and employees of shared service centers as examples when applying paragraph .A4b(1) of AS 2101, without defining such terms too prescriptively.

Definition of 'other auditor'

Many global companies have complex organizational structures with multiple business units including subsidiaries, divisions, branches, components, or investments, both domestically and internationally. When the lead auditor applies AS 2101.11 to determine the extent to which audit procedures should be performed at selected locations or business units, multiple offices within the same audit firm in a certain jurisdiction may perform audit procedures over selected locations or business units. In these circumstances, individual offices of the same registered public accounting firm are often treated as an 'other auditor' under current practice. For example, the lead auditor located in the New York office would inform the 'other auditors' in the Chicago and Atlanta offices of the scope of work to be performed and the tolerable misstatement over specific components (akin to proposed revisions to AS 1201.08). Similarly, the other auditors in the Chicago and Atlanta offices would provide interoffice reporting to the lead auditor in the New York office based on firm policies and procedures (akin to proposed revisions to AS 1201.12).

However, based on the definition of 'lead auditor' within the Second Supplemental Request for Comment, it is our understanding that all offices within the same registered public accounting firm would

³ Supplemental Request for Comment, footnote 74, page 34.



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be considered to be part of the lead auditor. In the example above, because the New York, Chicago, and Atlanta offices are all offices of the same registered public accounting firm, they would all meet the definition of 'lead auditor', which we believe will be a change in current practice.

Further, we observe that the definition of 'other auditor' as proposed in paragraph .A5 of AS 2101 would create a difference when compared to the proposed ISA 600 (Revised), *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)* (referred to as Proposed ISA 600 (Revised)), that is expected to be finalized in December 2021. Specifically, we observe the following definition of 'Component auditor' in paragraphs 9(c) and A13 of Proposed ISA 600 (Revised) (underline added for emphasis)⁴:

9(c). Component auditor – An auditor who, at the request of the group auditor, performs audit work related to a component for purposes of the group audit. A component auditor is a part of the engagement team for a group audit. (Ref: Para. A13–A14)

A13. References in this ISA to the engagement team include the group auditor and component auditors. Component auditors may be from a network firm, a firm that is not a network firm, or the group auditor's firm (e.g., another office within the group auditor's firm).

Under Proposed ISA 600 (Revised), a component auditor may be from another office within the group auditor's firm. However, another office within the lead auditor's firm would not meet the definition of an 'other auditor' as proposed in the Second Supplemental Request for Comment. We acknowledge the Board discussed the difference in definitions with non-PCAOB rules in the Supplemental Request for Comment, but we did not observe further commentary on this issue from the Board in the Second Supplemental Request for Comment. Such a difference and change from current practice may create unnecessary confusion that increases the likelihood of misinterpretation and may have a negative impact on audit quality due to misapplication of the final amendments. We recommend the Board further consider this issue and its implications on current practice and provide additional guidance in the final amendments with respect to the expected change in performance when engagement teams from multiple offices within a registered public accounting firm participate in the audit, to assist firms in their implementation efforts.

Determination to serve as lead auditor

As expressed in our 2017 comment letter, we continue to believe the sufficiency of participation in the audit by the lead auditor should be a risk-based assessment with collective consideration of quantitative and qualitative factors. Accordingly, we agree with the proposed third consideration added to paragraph .06A of AS 2101 that allows the lead auditor to consider the extent of the engagement partner's firm's supervision of the other auditors' work in the determination of sufficiency of participation.

However, given the diversity and complexity of company structures and the corresponding organization of audits involving other auditors that exist today and will continue to evolve over time, we believe that the three considerations proposed in paragraph .06A of AS 2101 – namely importance of the locations or

⁴ The International Auditing and Assurance Standards Board Quarterly Board meeting, September 13-17, 2021 Agenda Item 2-D, pages 9 to 10.



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business units, the risks of material misstatement, and the extent of supervision – may not be sufficiently comprehensive to capture all facts and circumstances that may arise.

Under a risk-based approach, while the three considerations proposed in paragraph .06A of AS 2101 are relevant and helpful, a lead auditor may need to consider other quantitative and qualitative factors when making the sufficiency of participation assessment. Therefore, we recommend the PCAOB allow the lead auditor to use professional judgment and consider other relevant factors that may be necessary based on the facts and circumstances of the audit in their determination as to whether they can serve as the lead auditor. We suggest the following changes to the lead in of paragraph .06A of AS 2101 (similar to paragraph .12 of AS 3101) for the Board’s consideration:

.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, as well as other factors specific to the audit:

Other auditors’ compliance with independence and ethics requirements

We appreciate the modifications to paragraph .06D of AS 2101 in the Second Supplemental Request for Comment in response to comments received by the PCAOB related to the lead auditor’s procedures in determining the other auditor’s compliance with independence and ethics requirements.

However, given the definition of ‘other auditor’ intentionally includes both the firm and individuals, we continue to believe further clarity is needed regarding the level (i.e., firm, individual, or both) at which the lead auditor is expected to apply the requirement in paragraph .06Da:

.06D In an audit that involves other auditors, 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;

If the PCAOB’s intent is for the lead auditor to apply the above requirement at the individual engagement team member level, we think this overlaps with the requirement in paragraph .06Ha(2) of AS 2101. Specifically, paragraph .06Ha(2) requires the lead auditor to obtain an understanding of the knowledge, skill, and ability of the other auditor’s engagement team members with respect to the PCAOB standards and rules, and SEC rules and regulations, which include PCAOB independence and ethics requirements and SEC independence requirements.

If the intent is for the lead auditor to apply the requirement in paragraph .06Da at the firm level, we request additional practical guidance as to how audit firms may apply or consider knowledge and experience requirements at the firm level (as audit firms commonly apply or consider knowledge and experience requirements at the individual engagement team member level). Further, we seek to better



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understand the incremental value provided by a firm-level independence and ethics requirement in paragraph .06Da when the individual-level requirement already exists in paragraph.06Ha(2). We believe the evaluation at the individual engagement team level in accordance with the requirement in paragraph .06Ha(2) is most appropriate to enable a lead auditor to evaluate the other auditors' independence and ability to comply with PCAOB independence and ethics requirements and SEC independence requirements. However, should the Board believe an evaluation at both the firm and individual level is necessary, we request that additional guidance be provided to guide lead auditors in how to consider the information about the two different levels, especially when that information may differ. For example, consider a scenario where the other auditors' firm has a 'low' level of knowledge and experience in applying independence and ethics requirements under paragraph .06Da, but the other auditors' engagement team members have a 'high' level of knowledge and experience in applying those requirements under paragraph .06Ha(2). In this scenario, it is unclear whether the 'high' level of knowledge and experience at the individual level under paragraph .06Ha(2) should be given more weight compared to the 'low' level of knowledge and experience at the firm level, or how the lead auditor is expected to evaluate the other auditor under such a scenario.

We acknowledge that based on the discussion on page 19 of the Second Supplemental Request for Comment, the new Note added to paragraph .06D is intended to address practicability challenges in applying the requirement in paragraph .06Da of AS 2101. However, we do not believe the new Note fully achieves its intended purpose.

Furthermore, the placement of the new Note at the end of paragraph .06D and the reference within the Note "For the matters described in paragraph .06D,..." seems to indicate the Note has broader application than just paragraph .06Da. This may cause further confusion as to whether the other requirements in paragraph .06D should be applied at the firm level or individual engagement team member level. For example, as it relates to paragraph .06Db(1), we believe the written affirmation requirement on policies and procedures would apply at the firm level and not to individual engagement team members. But the new Note added to paragraph .06D raises questions as to whether the Board expects the requirement in paragraph .06Db(1) to also apply at the individual engagement team member level.

As illustrated above, without further clarity, there is a risk of misinterpretation that could result in the lead auditor performing unnecessary procedures, which in turn may lead to increased costs and potentially harm audit quality as a result of incorrectly focused efforts.

In addition, paragraph .06Db(2) of AS 2101 requires the lead auditor to obtain from the other auditor 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. With respect to other auditors that are affiliated with the lead auditor, such information is already being obtained by the lead auditor, in many cases from a centralized source, so that the lead auditor can fulfill their communication responsibilities pursuant to PCAOB Rule 3526. We request additional guidance as to whether obtaining such information from a centralized source that is accessible by all of the firms that are affiliated with the lead auditor would fulfill the requirement in paragraph .06Db(2), or if the lead



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auditor would also be expected to obtain a written description of the same information directly from an affiliated firm that is an other auditor.

Applicability

We are not aware of any strong arguments that would indicate that audits of emerging growth companies and broker dealers should be excluded from the proposed amendments and proposed standard. We, therefore, agree with the Board that the proposed amendments and proposed standard should apply to audits of these types of entities.

Effective date

Substantial changes to our audit methodology will be required to effectively implement the final amendments and final standard, if they are consistent with what is reflected in the Second Supplemental Request for Comment. It will be necessary to develop and issue policies and procedures and produce and provide training to our audit professionals, including those throughout our network member firms who participate in audits conducted in accordance with PCAOB standards.

Further, planning and coordination of audits involving other auditors typically occurs early in the audit planning phase (e.g., March for December fiscal year-end engagements). Therefore, once updates to methodology, guidance, and training are complete, the lead auditor will require sufficient time to successfully execute by incorporating the new requirements into the audit plan, and for proper coordination and communication to occur between the lead auditor and the other auditors.

Consequently, we recommend that the effective date should be no earlier than two years after the SEC's approval of the final amendments and final standard.

Other editorial comments

Included below are minor editorial comments for the Board's consideration.

In paragraph .06Dc of AS 2101, the lead-in sentence indicates that the requirements that follow apply to the matters described in items a and b. We are unclear as to how the requirements that follow apply to item a.

In paragraph .06F of AS 2101, the words 'investigate' and 'investigation' are used. Those words may convey a stronger meaning than the PCAOB intended. We would recommend that the Board consider revising the words to 'evaluate' and 'evaluation', or similar words, to avoid any potential misinterpretation.

In paragraph .A3a(2) of AS 2101, in order to avoid any potential misinterpretation that the definition includes all specialists employed by the lead auditor, regardless of whether they participate in the audit, we would recommend that 'participating in the audit' be replaced with ', and participate in the audit,'.

We note that throughout the proposed amendments, there is a reference to 'locations or business units', but paragraph .A6 of AS 2101 only references 'business units'. We would recommend that 'locations or' be added to that paragraph.



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Footnote 1A of AS 1201 points to the definition of 'engagement partner' in Appendix A. We note that the other defined terms in that standard, such as 'engagement team', 'lead auditor', 'other auditor', and 'referred-to auditor', are addressed in paragraph .A1b of Appendix A, which refers to Appendix A of AS 2101. Since 'engagement partner' is also defined in Appendix A of AS 2101, we would recommend revising footnote 1A to also point to Appendix A of AS 2101, as is done for the other defined terms. Paragraph .A1a of Appendix A could then be removed, and paragraph .A1b could be revised to also include the term 'engagement partner'.

* * * * *

We appreciate the Board's careful consideration of our comments and observations, and support the Board's efforts to increase accountability of the lead auditor and improve audit quality and investor protection. If you have any questions regarding our comments included in this letter, please do not hesitate to contact Matt Doyle ((212) 954-2187 or mrdoyle@kpmg.com) or Rob Chevalier ((212) 909-5067 or rchevalier@kpmg.com).

Very truly yours,

KPMG LLP

cc:

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 Christina Ho, Member
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 Barbara Vanich, Acting Chief Auditor
 Dima Andriyenko, Acting Deputy Chief Auditor

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November 30, 2021

By email: comments@pcaobus.org

Office of the Secretary
PCAOB
1666 K Street, NW
Washington, DC 20006-2803

Re:
PCAOB Rulemaking Docket Matter No. 042

PCAOB 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

Dear Office of the Secretary:

Mazars USA LLP (“Mazars”) welcomes the opportunity to comment on PCAOB Release No. 2021-005 Rulemaking Docket Matter No. 042 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* (the “proposed standard”). Mazars appreciates the PCAOB’s work to enhance the quality of audit engagements through the revision of the existing PCAOB standards.

Currently, Mazars USA has over 100 partners and 800 professionals across the United States and is an independent member firm of the Mazars Group, an organization with over 1,100 partners and 26,000 professionals in over 90 countries around the world, and a member of Praxity, a global alliance of independent firms. As a member of an international network, we strive for continuous improvement by collaborating with our other member firms to set high standards for audit quality throughout the Mazars Group and tailoring these standards to meet the auditing and professional practice standards established by the Public Company Accounting Oversight Board as well as U.S. Generally Accepted Auditing Standards established by the American Institute of Certified Public Accountants and the International Auditing and Assurance Standards Board’s (IAASB) standards for auditing, assurance, and quality control.

Our views on the proposed standard is driven by our position in the U.S. marketplace as a medium sized public accounting firm servicing mostly small to mid-size public and private businesses in a variety of industries and as a member firm in a global network. As a member in our global network, we frequently act as group or component auditors and thus have a keen interest in standards impacting the relationship between lead auditors and other and referred-to auditors. We recognize the PCAOB’s extensive efforts related to addressing the topic of audit quality in the increasing circumstances where more than one audit firm or individual accountants may assist the lead auditor (also referred to as a group or shared audit). We agree that clarifying the roles and responsibilities and strengthening the relationship between lead auditors and other and referred-to auditors is key to overall audit quality in the performance of multiple audit firm audits. We find the PCAOB’s proposed standard, broadly consistent with the IAASB’s recent standard setting activities around Proposed International Standard on Auditing 600 (Revised), *Special Considerations—Audits of Group Financial Statements (including the Work of Components Auditors)*. The additional revisions proposed support conceptual consistency across standard setters allowing firms to build their audit methodology to meet compliance requirements more efficiently and promote quality in execution of audits involving multiple audit firms.



Generally, we agree with the proposed standard which includes clarification and enhancements to existing standards. Our comments on the specific questions posed follow:

Questions

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

Response: As more clients have global operations, lead auditors have been increasingly involving other auditors in audit engagements. In recent years, the frequency and quality of the communication between the lead auditors and other auditors has improved. We note that group audit instructions often include more detailed guidance for the other auditors to understand risk and lead auditor expectations around specific audit areas. More significantly, the use of technology, such as video conferencing, has led to more timely and effective supervision and review by lead auditors. The ability to have a discussion and share documents in real time is a significant improvement in the ability to supervise and review compared to the past when lead auditors relied primarily on phone discussions, formal deliverables or live visits, which often occurred toward the end of the engagement.

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?

Response: Increasingly, multinational companies are establishing shared service centers and centralizing information technology operations which often increases the need to use other auditors. Additionally, technological advances by issuers and auditors such as use of data analytics, document portals and video conferencing have, in some instances, allowed lead auditors to perform audit procedures on business units of an audit client where previously they may have relied on other auditors.

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?

Response: The definitions of “lead auditor” and “other auditor” are clear.

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?

Response: The proposed considerations regarding serving as a lead auditor are appropriate. However, the language used to refer to the portion of the company’s financial statements for which other auditors perform audit procedures is inconsistent and thus not clear. In AS 2101.06Aa, the language used is “...in relation to the financial statements of the company as a whole.” In AS 2101.06Ab, the language used is “...in comparison with the portions for which the other auditors perform audit procedures.” We believe that the language in AS 2101.06Ab is clearer and thus recommend conforming such language in AS 2101.06Aa.

Additionally, AS 2101.06Ac footnote 4B references to AS 1201.06. Given AS 1201.07 through AS 1201.15 address supervision of other auditors, we believe that footnote 4B should reference AS 1201.06 through AS 1201.15.



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?

Response: The proposed requirements relating to the lead auditor's responsibilities regarding other auditors' compliance with the independence and ethics requirements are appropriate.

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?

Response: The proposed amendments relating to the knowledge, skill, and ability of the other auditor, revised by this release are clear and appropriate. We believe that the proposed amendments provide intended scalability to assess the knowledge, skill and ability of the broad range of other auditors that may be used. We also agree with the requirement to obtain a written affirmation from the other auditor that their engagement team members possess the knowledge skill, and ability to perform their assigned tasks.

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?

Response: The proposed amendments relating to the supervision of the work of the other auditor are clear and appropriate. The focus of the standard on the lead auditor determining the necessity and extent of involvement in supervision, including potentially determining the nature, timing and extent of procedures performed by the other auditors provides scalability to allow the lead auditor to manage risk and accommodate for any issues noted related to the knowledge, skill, and ability of the other auditors.

8. In multi-tiered audits, are the proposed requirements for situations in which the lead auditor directs another 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?

Response: The requirements related to first other auditors who perform supervisory procedures over second other auditors is clear and appropriate.

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?

Response: The proposed requirements in audit planning are clear and appropriate.



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

Response: The modifications are appropriate and clear.

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?

Response: The amendments proposed are clear. We would recommend considering expanding the standard to address situations where the investor has a different reporting period or where the accounting or auditing standards of the investee differ from those of the investor.

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?

Response: The economic analysis presented appears adequate for the purpose of assessing the changes proposed. We are not aware of other data sources or academic research that should be considered.

Overall, we support the proposed standard and believe it will result in higher quality group audits. Many of the changes to the proposed revisions presented in the 2017 supplemental request for comment make the standard more principles based and, in doing so, improve the scalability of the proposed standard, which leads to enhanced standards compliance. We applaud the PCAOB's thoughtful consideration of the comments to the 2017 supplemental request and appreciate the opportunity to comment.

We would be pleased to discuss our comments with you at your convenience.

Please direct any questions to:

- Wendy Stevens, Practice Leader, Quality & Risk Management
(Wendy.Stevens@Mazarsusa.com)
- George Parker, Partner, Quality & Risk Management
(George.Parker@Mazarsusa.com)

Very truly yours,

A handwritten signature in black ink that reads "Mazars USALLP". The signature is written in a cursive, slightly stylized font.

Mazars USA LLP



National Association of State Boards of Accountancy

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November 16, 2021

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, D.C. 20006-2803

Via email: comments@pcaobus.org

Re: *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 Rulemaking Docket Matter No. 042

Dear Members of the Public Company Accounting Oversight Board:

The National Association of State Boards of Accountancy (NASBA) appreciates the opportunity to offer comments on the Proposed Amendments referred to above. NASBA's mission is to enhance the effectiveness and advance the common interests of the Boards of Accountancy that regulate all Certified Public Accountants (CPAs) and their firms in the United States and its territories, which includes all audit, attest and other services provided by CPAs. State Boards are charged by law with protecting the public.

In furtherance of that objective, NASBA offers the following comments on the Proposed Amendments.

General Comment

There are other projects underway by international and national standard setters regarding audits of group financial statements and using the work of other auditors. Consideration should be given to the status of these ongoing projects as it provides an opportunity for harmonization among standard setters, which is in the public interest.

Request for Comment 1:

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

While we understand anecdotally that there have been changes in the use of other auditors, we believe that we do not have a further basis of commenting on this question at this time.

Request for Comment 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?

In the COVID era, we have observed a far greater use of technology which facilitates the performance of audits and peer reviews of those audits remotely. The greater ability to perform audits remotely could result in a change in the use of other firms in performing the audits and in turn the designation of lead and other auditors. Likewise, it is possible that the lead auditor could find themselves in a position in which they are auditing less of the company than the other auditors.

Request for Comment 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?

The International Auditing and Assurance Standards Board (IAASB) is currently working on proposed revisions to International Standard on Auditing (ISA) 600 (revised), *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)*. The AICPA’s Auditing Standards Board (ASB) is also working on a proposal to Statement on Auditing Standards AU-C 600, *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)*.

Consideration should be given to the status of these ongoing projects as it provides an opportunity for harmonization among standard setters, which is in the public interest.

Request for Comment 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 misstatements, and extent of the engagement partner’s firm’s supervision – appropriate and clear?

We believe that 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 locations, risks of material misstatements, and extent of the engagement partner’s firm’s supervision is appropriate and clear.

Request for Comment 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?

We do not have a basis for commenting on this question at this time.

Request for Comment 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?

We believe the proposed amendments relating to the knowledge, skill, and ability of the other auditor revised by this release are clear and appropriate.

We agree with the 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. In addition, the written affirmation from the other auditor should include a representation that the personnel who participate on the engagement are in compliance with the other auditor's jurisdictional registration status and licensing requirements.

Request for Comment 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 amendments? If so, what are the specific challenges, and how could the proposed requirements be modified to address them?

We believe that 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 are appropriate and clear.

Request for Comment 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?

Due to the challenge of developing rules that would anticipate the many permutations that exist in multi-tiered audits, we do not believe that the proposed requirements are appropriate. We believe that the complex multi-tiered audit situation requires a principles-based approach, which is embodied in the existing standards, rather than a codified, rules-based approach.

Request for Comment 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 firms' 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?

We believe the proposed requirements are clear and appropriate. Providing examples and illustrations as implementation guidance would assist in making the requirements understandable.

Request for Comment 10:

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

We believe that the modifications in proposed AS 1206, including Appendix B, to reflect the auditor's report language in AS 3101 are appropriate and clear.

Request for Comment 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?

We believe the proposed amendments to AS 1105.B1 are clear and appropriate. The guidance provides a reasonable approach and is not too prescriptive to allow for the lead auditor to make judgments.

Request for Comment 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 impact? 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?

Public Company Accounting Oversight Board
November 16, 2021

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We have no comment on the economic analysis and are not aware of other data sources that the Board should consider in establishing the baseline for evaluating economic impact.

Request for Comment – Audits of Emerging Growth Companies

The Board requests further comments, 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.

While the risk profile of an EGC is different from more mature entities, the proposed amendments should not be applied any differently to EGCs. To exclude EGCs from the proposed amendments in this release would be inconsistent with protecting the public interest.

Request for Comment – 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.

We have no basis to comment on the amount of time auditors would need to prepare; however, we recommend the Board allow ample time for auditors to be able to implement the proposed amendments and new auditing standard correctly. Effective implementation of a new standard is in the public interest.

* * *

We appreciate the opportunity to comment on the Proposed Amendments.

Very truly yours,



W. Michael Fritz, CPA
NASBA Chair



Ken L. Bishop
NASBA President and CEO



November 30, 2021

Office of the Secretary
 Public Company Accounting Oversight Board
 1666 K Street, N.W.
 Washington, DC 20006-2803

RE: PCAOB Rulemaking Docket Matter No. 042

Dear Madam Secretary:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (the PCAOB or "the Board") 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* included in PCAOB Release No. 2021-005 (the "release"). We commend the Board for continuing to seek public input to inform its standard setting.

How the landscape in which multi-location audits are conducted has and continues to evolve

Since the Board commenced its standard-setting activities related to other auditors in 2016, the landscape in which multi-location audits are conducted has continued to evolve. Broadly, the manner in which many companies are structured continues to change – some businesses are increasingly centralizing and standardizing processes, while others are expanding globally and have highly dispersed operations. Laws or regulations in the jurisdictions in which companies and auditors operate also affect how a multi-location audit is conducted, including what audit documentation can be provided to lead auditors. The increased use of technology has made it easier for lead auditors to be more involved in the work of other auditors, facilitating review and resulting in more frequent and comprehensive communications with other auditors.

We support the PCAOB's consideration of enhancements and the promotion of consistency in the lead auditor's performance when supervising other auditors. The nature of interaction between the lead auditor and other auditors is important to audit quality. We appreciate the PCAOB's acknowledgement that the existing methodologies of larger firms continue to emphasize the need for the lead auditor to be sufficiently involved in the work of other auditors, as well as to oversee the work of other auditors using a risk-based approach. This is because larger firms' methodologies incorporate the framework provided by ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, which is, in our view, a robust framework for multi-location audits. The IAASB has also devoted significant attention to initiatives that are intended to enhance firms' system of quality control, as well as strengthen responsibilities designed to bring quality at the engagement level, including in multi-location audits. We appreciate the PCAOB considering whether to leverage these efforts in light of the shared goals of audit quality.

Additionally, global network firms (GNFs), have made significant investments in developing network policies, methodology, technology, training, and quality review processes. Effective systems of quality control underpin audit quality. Leveraging our global network is an important part of how we perform multi-location audits, including how we determine the extent of supervision of other auditors. In conducting multi-location audits, our engagement teams consider relevant network information and prior experience with other auditors, not just the fact that the respective firms are part of a common network.



Key principles that should underpin a quality multi-location audit

We agree that AS 1205, on its own, may not be sufficient to consistently promote the appropriate involvement of lead auditors when other auditors are used. We believe the PCAOB should build upon the approach set out in AS 1205 by codifying observed best practices. However, the final standards must be capable of being scaled and tailored to varying circumstances by a range of firms in and outside of the US. It is important that the final standard supports auditors in being able to scope and plan the audit as is most appropriate in response to the nature and circumstances of the company. We are concerned that certain aspects of the proposed requirements are not sufficiently scalable, particularly when applied in complex global multi-location audits, as further detailed below.

For the proposed enhancements to be effective, it should be clear how the requirements in various PCAOB standards interact with respect to scoping a multi-location audit and deciding whether, and to what extent, to involve other auditors, including how those other auditors will be supervised. As PCAOB inspection observations indicate (page 58 of the release), audit quality improves when there is regular, consistent communication between the lead auditor and other auditors. Good practices cited include, among others, holding planning meetings with other auditors, reviewing audit work papers remotely or during site visits, and meeting with local management during site visits. This is consistent with our experience and one of the key tenets of our global network methodology – planning and performing a multi-location audit is an iterative process involving two-way communication between lead auditors and other auditors. Other auditors can be involved in a number of ways – from performing an audit of the entire financial information related to a location or business unit, an audit of certain accounts and disclosures, or specified procedures developed and communicated by the lead auditor.

Principles-based, scalable requirements can be used to promote adequate focus on the most significant judgments made in a multi-location audit. We therefore support the PCAOB's approach that the lead auditor exercises professional judgment in determining the nature, timing, and extent of supervision of other auditors. However, we are concerned that certain of the proposed requirements could be viewed as setting out a formulaic, prescriptive approach to written communications between lead auditors and other auditors that could become overly administrative, and detract from the most relevant aspects necessary to effectively perform audit procedures, including the real-time communications that we believe benefit quality today.

We believe that in order for the proposed requirements to maintain or enhance audit quality, the final standards should reflect the following principles:

- The firm's determination that it can serve as the lead auditor considers both quantitative and qualitative factors – with the overriding principle that the lead auditor must be able to be sufficiently involved in the work of other auditors. How that involvement will occur in practice may vary - the extent of the lead auditor's supervision of other auditors should be commensurate with the risks of material misstatement at locations audited by other auditors, and take into account the lead auditor's views about the knowledge, skill, and ability of the other auditor and, where applicable, relevant information from the network.
- Systems of quality control must be leveraged by both lead auditors and other auditors, including with respect to consideration of the other auditor's knowledge, skill, and ability and compliance with independence requirements. The proposed standards should be underpinned by the expectation of compliance with the PCAOB's current quality control standards. In this regard, we believe it is more appropriate for the PCAOB's project on quality control to advance first in order for the Board to better consider what information could be required to be shared about a firm's system of quality control in the context of a multi-location audit (e.g., as a written affirmation).



- While a focus on increased involvement by the lead auditor is appropriate, the final standard should strike a balance between the responsibilities of the lead auditor and the other auditor. It should be clear that other auditors are responsible for the performance of their own work in accordance with PCAOB standards, in particular those related to planning and supervision.
- Communications between lead auditors and other auditors should occur in a timely manner, and focus on the most significant judgments that are relevant to the consolidated financial statements, as well as the work to be performed at the location or business unit, and be in writing when necessary.

Recommendations

We appreciate the PCAOB's continued interest in understanding whether there are practical challenges associated with the proposed standards. We believe this is an important consideration - if what is expected to comply with proposed requirements is not clear or does not take into account potential practical challenges, there will likely be inconsistent implementation, which would not benefit audit quality and investor protection. On this basis, we have included in the appendix initial views on what we see as potential practical challenges or areas where additional clarification is necessary before finalizing the proposed standards. We welcome further opportunities to engage with the Board to more fully explain how changes in the global business environment - as a result of regulatory impacts and developments by international standard setters, have affected how we perform multi-location audits. We have also commenced efforts to consider the impacts that are likely to occur as a result of our network adopting ISA 600 (Revised), which has also helped inform our views regarding the PCAOB's proposals.

In the appendices, we have provided responses to each of the questions outlined in the release, and have offered an alternative approach to certain requirements to illustrate how we believe they could be reformulated to respond to our concerns about practicality and complexity while still achieving the PCAOB's objectives.

Effective date

Given the potential impact of the proposals on planning, risk assessment, and communications, we believe the PCAOB should allow for implementation to take place over a minimum of two audit cycles (i.e., the proposals should become effective no sooner than for audits beginning two years after the year of SEC approval). Adequate lead time allows firms to effectively implement the proposals, including to develop training for the practice for both lead auditors and other auditors, which benefits audit quality. Dialogue with the profession as firms work to implement the proposals will inform the PCAOB if further guidance may be needed to promote appropriate consistency in interpretation.

* * * * *

We appreciate the opportunity to express our views and would be pleased to discuss our comments or answer any questions that the PCAOB staff or the Board may have. Please contact Heidi Schuetze at heidi.schuetze@pwc.com or Brian Croteau at brian.t.croteau@pwc.com regarding our submission.

Sincerely,

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP



Appendix 1

Responses to specific questions

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

Our firm's methodology complies with the requirements of PCAOB standards, as well as ISA 600, which came into effect for 2010 audits. Since the network's adoption of ISA 600 (and the US Auditing Standards Board's similar standard), changes to auditor practices related to the use of other auditors have been particularly related to (i) the increased use of and investment in audit tools and technology; (ii) investments in systems of quality control; and (iii) the use of service delivery centers (referred to in the PCAOB's release as "shared service centers").

As noted in the PCAOB's release, firms such as ours have issued tools and guidance to support the application of our methodology as the environment in which we conduct multi-location audits has evolved. Our firm policies and procedures are premised on the view that effective two-way communication throughout the audit is crucial to audit quality, including how we direct and supervise other auditors and how we review their work. In addition, our planned involvement in the work of other auditors is based on our understanding of their capabilities and our assessment of the significance, risk, and complexity associated with the location or business unit where they will perform work. Through communications and training, we have emphasized these concepts and shared best practices.

Our firm has made significant investments in technology that allows for enhanced collaboration with clients as well as other auditors within our network. Our suite of tools is designed to facilitate the exchange of information between lead auditors and other auditors, streamlining communications, enhancing collaboration and workflow, and providing greater visibility via real-time status updates across multi-location audits. Additionally, in the COVID-19 working environment, we provided guidance on how to enhance coordination with other auditors through the use of virtual site visits.

Additionally, global network firms (GNFs), have made significant investments in developing network policies, methodology, technology, training, and quality review processes. Effective systems of quality control underpin audit quality. Leveraging our global network is an important part of how we perform multi-location audits, including how we determine the extent of supervision of other auditors. In conducting multi-location audits, our engagement teams consider relevant network information and prior experience with other auditors, not just the fact that the respective firms are part of a common network.

Lastly, our audit model has evolved to one that centralizes processes to promote quality, consistency, and efficiency through use of shared service centers. These shared service centers are used by both lead auditors and other auditors within the network to complete certain audit procedures.

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?

The business world is evolving rapidly. Companies are facing fast-changing global issues, sustained economic uncertainty, disruptive new technologies, and increasingly interdependent stakeholder relationships that are changing their business models. Approaches to scoping a multi-location audit are evolving in light of the structure of companies and their financial reporting processes and controls and the need to design audit approaches that are most effective in response to the assessed risks.



We have observed an evolution in issuer circumstances particularly due to: (i) changing organizational structures, including increased globalization and centralization through the use of their own shared service centers and reorganizations for tax purposes; (ii) the use of new technology and integrated systems; (iii) the impact of COVID-19, which in some cases necessitated the use of virtual communication tools and the virtual execution of internal controls; and (iv) the impact of rules and regulations across jurisdictions, such as mandatory firm rotation in the EU and access restrictions in certain territories. We have been able to accommodate these changes as they occur because our approach to planning and performing a multi-location audit is sufficiently nimble and is premised on a sufficient understanding of the company and the environment in which it operates, and internal control, which informs our robust risk assessment and design of procedures to specifically respond to those risks.

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?

We believe the proposed definitions of lead auditor and other auditor are sufficiently clear.

Employees of shared service centers, secondees, leased personnel in firms with alternative practice structures, consulting firms, and temporary workforce agencies may often work in the same capacity as personnel on the engagement team. We believe it is the PCAOB’s intent that these individuals be included in the definition of “lead auditor,” provided they work under the lead auditor firm’s direction and supervision and function as the firm’s employees. Accordingly, we support the additional clarification in the definition of the lead auditor, and the additional note that identifies secondees as an example of such other individuals.

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?

We generally agree with the considerations regarding serving as the lead auditor as included in the proposed standard, as well as the PCAOB’s intent 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. Determining whether the firm can serve as the lead auditor involves significant professional judgment, taking into account quantitative and qualitative factors specific to the audit.

It continues to be important for the standard to take into account the fact that, in certain jurisdictions, including the US, laws or regulations require an auditor licensed in the jurisdiction to sign the auditor’s report. This could create a conflict when determining which firm should serve as the lead auditor, specifically when a company’s operations are primarily outside the jurisdiction in which the auditor’s report must be signed. In our view, this is a qualitative consideration that must be taken into account to find a solution that appropriately considers audit quality.

The new criterion in AS 1201.06Ac better accommodates such circumstances, but we believe further emphasis could be given to acknowledge that (i) the three criteria in AS 1201.06A are not mutually exclusive, and (ii) auditors will need to consider the facts and circumstances specific to the audit (e.g., legal and licensing restrictions of certain jurisdictions). Additionally, the lead auditor may often not be able to fully consider certain criteria in a divided responsibility situation, for example related to the identified risks of material misstatement of a location or business unit audited by a referred-to auditor. Accordingly, the overall principle of involvement (consistent with AS 1201.06B) is likely more relevant than the concept of “supervision” in AS 1201.06Ac.



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?

We support the principle of enhancing communications between lead auditors and other auditors in a multi-location audit in a timely manner to better enable the lead auditor to determine compliance with independence and ethics requirements in accordance with AS 2101.06D. We were encouraged to see that the PCAOB proposed further amendments in the most recent release in light of comments received by the Board about the practicality of additional proposals set out in 2017. However, there may also be practical challenges associated with certain aspects of the newly proposed approach, as described below.

Written affirmations

We agree with retaining the requirement in AS 1205 for each other auditor to provide a written affirmation as to whether the other auditor is in compliance with the independence and ethics requirements, as the other auditor should be accountable for that compliance. We also agree that the other auditor’s firm’s system of quality control should underpin this written affirmation. Accordingly, we support the principle of obtaining the new written affirmation required by AS 2101.06Db about the other auditor’s policies and procedures relating to independence and ethics requirements.

Consistent with existing quality control standards, we believe the other auditor could provide a written assertion that the other auditor [firm] has policies and procedures that *are intended to* (emphasis added) provide it with reasonable assurance that the other auditor [firm] maintains compliance with SEC independence requirements and PCAOB independence and ethics requirements. We suggest this be clarified. If this is not the PCAOB’s intent, further consideration would be needed for the PCAOB to address the basis on which such assertions are intended to be made and the challenges that may arise between providing a written affirmation that the policies and procedures provide reasonable assurance at many points in time during a year given the way in which firm’s systems of quality control operate (e.g., ongoing monitoring and remediation, periodic testing, and, in accordance with ISQM 1, an annual evaluation that the system provides the firm with reasonable assurance), as part of the PCAOB’s separate project on quality control.

Further guidance could also be helpful to explain the intent of the requirement. As an example, when the other auditor does not have policies and procedures, it is unclear what the lead auditor’s response should be with regard to the description of how the other auditor determines its compliance with the requirements. In our view, it could be read as implying the lead auditor would have to evaluate the basis for the other auditor’s written affirmation of compliance with independence and ethics requirements, which in most cases lead auditors are not necessarily well-placed to do.

Separately, we agree that communication between the lead auditor and other auditor on changes in circumstances should happen in a timely manner. However, we do not believe it is necessary for other auditors to reaffirm in writing every time an update is communicated by the lead auditor given the potential this creates for excessive written communication back and forth and additional effort for all the other auditors to make such reaffirmation each time. Complying with this degree of frequency could detract from audit quality by being overly focused on record keeping and not on timely communication and resolution of issues. We believe the lead auditor should have discretion as to whether to request written updates during the audit, with the principle that the other auditor be expected to communicate any potential issues that may reasonably be thought to bear on independence in a timely manner, and that the written affirmation be updated in connection with the other auditor’s audit documentation in accordance with AS 1215.19.



Information that may contradict an affirmation or otherwise indicate it may not be reliable

We support the PCAOB's proposal for the lead auditor to perform additional procedures when there are indications that written affirmations provided by other auditors may not be reliable. If such information comes to light (including based on what is communicated by the other auditor), the lead auditor should take action to understand both the effect on the determination of compliance with independence and ethics requirements in the context of the multi-location audit, as well as the implications for using the work of the other auditor. For example, the lead auditor may become aware of relevant information about firms for which there may be concerns about independence or their systems of quality control (e.g., due to enforcement actions or findings of external inspections or other regulatory reviews). In our view, such information may be relevant to discuss with the other auditor but, in and of itself, does not necessarily indicate that the other auditor's written affirmations are not reliable.

Reference to the audit client

We agree that other auditors should be aware of, and confirm that they have complied with, the SEC and PCAOB independence and ethics requirements that apply to the work they are asked to perform.

To be consistent with existing independence requirements, we suggest the PCAOB clarify that the communications between the lead auditor and other auditor be focused on ensuring that the other auditors are appropriately aware of which PCAOB and SEC requirements are relevant to *their* audit client and *its* affiliates. For example, in the case of a significant influence investee that is the other auditor's audit client, the other auditor will be required to be independent of the significant influence investee and other entities which meet the affiliate definition when looking from the perspective of that significant influence investee. However, the parent company and certain other entities that are part of the consolidated financial statements on which the lead auditor is reporting may not be affiliates of the significant influence investee even though they are affiliates of the parent audit client from the lead auditor's perspective.

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 challenge?

We agree with the importance of gaining an understanding of the knowledge, skill, and ability of the other auditor. However, we are concerned there are practical challenges with how this is articulated in the proposals. Paragraph .06Ha of AS 2101 would require the lead auditor to 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 (emphasis added)*. As currently drafted, it is unclear as to whom this may apply, and on a large multinational audit, could be interpreted as the lead auditor having to obtain such understanding of a significant number of individuals, which is impracticable. In our view, it may be most meaningful to focus on gaining an understanding of the knowledge, skill, and ability of the engagement partner responsible for the work of the other auditor engagement team and instruct the other auditor engagement partner to make the lead auditor aware of any concerns about the knowledge, skill, and ability of its team. We suggest revising the requirement to focus on obtaining an understanding of the knowledge, skill, and ability of the other auditor more holistically (by deleting the phrase "engagement team members who assist the lead auditor with planning or supervision").

There are often important network-level policies and procedures, including in relation to common training curriculum and monitoring of quality, that provide the lead auditor with information relevant to considering whether the other auditor has the appropriate knowledge, skill, and ability. We believe these policies and procedures, together with the lead auditor's experience in working with the other auditor, can be leveraged to a great extent when the lead auditor and other auditor are part of the same network.



Importantly, this understanding would be supplemented by the other auditor's written affirmation that its work was performed in accordance with PCAOB standards (including the requirement in AS 2101.06 relating to the other auditor's efforts in relation to the knowledge, skill, and ability of the other auditor's engagement team member), and the specific written affirmation in paragraph AS 2101.06Hb. We support obtaining this new written affirmation, as it is the mechanism by which the other auditor engagement partner is held accountable for exercising due professional care in accordance with AS 1015.

When an other auditor is not part of the same network, we would expect that efforts to understand the knowledge, skill, and ability of the other auditor would focus on inquiry, knowledge of and prior experience with the other auditor, and consideration of publicly-available information that might indicate concerns with the quality of the other auditor's work (including communications regarding the other auditor's professional competence from professional bodies, licensing authorities, or other third parties). The written affirmations from the other auditor would also be taken into account. If based on this, the lead auditor has concerns about the knowledge, skill, or ability of the other auditor, the planned involvement in the work of the other auditor would likely increase, or the lead auditor might ultimately conclude it is inappropriate to use the other auditor.

Separately, while we understand the PCAOB's rationale for the proposed amendment to AS 2101.16 to determine whether relevant knowledge of foreign jurisdictions is necessary when dealing with a multi-location audit, such consideration may only be applicable in certain circumstances. In our view, it would be more meaningful to incorporate consideration of whether to use other auditors in the context of judgments about multi-location audits in accordance with AS 2101.11.

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?

We support the Board applying a risk-based approach to the supervision of the work of other auditors, consistent with the premise of AS 1201.06. However, we are concerned that the manner in which the proposed requirements in AS 1201 are drafted may undermine the Board's intent in AS 1201.07 that the lead auditor can exercise judgment in determining the extent of supervision of other auditors (see further discussion below).

A more principles-based approach, focused on timely communication of the most relevant aspects necessary for both lead auditors and other auditors to effectively perform audit procedures in support of the multi-location audit, would be preferable. We respectfully offer an alternative means of presenting the proposed requirements related to supervision of other auditors in Appendix 2. Our proposed approach is consistent with proposed revisions to ISA 600, which address a number of the same matters the PCAOB is seeking to enhance in its standard setting. We would be pleased to provide additional rationale for these recommendations and share more specific details about our firm's methodology for multi-location audits.

Determining the nature and extent of supervision of other auditors

We believe including specific factors in the final standard would promote consistency for auditors in applying the elements of paragraph .06 of AS 1201 to other auditors. We suggest a focus on the following principles:

- The proposed standard should be clear that the lead auditor's understanding of the other auditor, including the assessment of the knowledge, skill, and ability of other auditors and previous experience with the other auditor, directly impacts the lead auditor's determination of the extent of supervision of the other auditor.



- Key judgments in accordance with AS 2101.11-.12, which sets the foundation of the lead auditor’s work in a multi-location audit, are also taken into account. These include the nature of the location or business unit at which other auditors will perform audit procedures, and the nature, timing, and extent of procedures they will perform.
- The lead auditor should be permitted to consider the extent of network-level policies and procedures, as well as processes and controls, in considering the knowledge, skill, and ability of the other auditor and determining the extent of supervision. In this regard, proposed ISA 600 (Revised) specifically acknowledges that policies or procedures established by the firm, or that are common network requirements or network services, may facilitate communication between the lead auditor and other auditors and support the lead auditor’s supervision of those other auditors and the review of their work.
- In a multi-tiered audit, it is important for the lead auditor to have an upfront understanding of whether and, if so, how a first other auditor may intend to use a second other auditor (see our responses to questions 8 and 9).

Supervision of other auditors, including communications

We agree with the objective outlined on page 29 of the release, which notes that the proposed amendments are designed to be scalable based on the lead auditor’s determination of the extent of supervision of the other auditor needed. However, we are concerned that certain requirements could be viewed as setting out a formulaic, prescriptive approach to written communications between lead auditors and other auditors that could become overly administrative, potentially result in incremental costs with little benefit, and potentially detract from other real-time communications that we believe benefit quality today.

We believe it is important that the requirements appropriately recognize that other auditors may be involved in a number of different ways (e.g., the performance of further risk assessment procedures, an audit of the entire financial information of the location or business unit (referred to hereafter as a “full scope audit”), an audit of certain accounts and disclosures of the location or business unit, or specified procedures on certain accounts and disclosures of the location or business unit). Additionally, we believe the lead auditor’s approach to supervision could vary significantly depending on whether or not the other auditor is part of the same network as the lead auditor.

We support the need for the other auditor to be made aware of information that is relevant and commensurate with the work they are being asked to perform. We also believe that senior members of the other auditor engagement team are best able to supervise and execute on the day-to-day responsibilities of the portion of the audit on which they are reporting, including review of audit documentation. Finally, we believe technology can be leveraged to support effective two-way communication and ultimately supervision of the work of other auditors.

Our recommendations in Appendix 2 are intended to capture all the elements addressed by the PCAOB in their proposed standards, albeit in a more principles-based manner, based on the following beliefs:

- The lead auditor’s work in a multi-location audit should be considered in the context of the consolidated financial statements, in regards to both planning the audit in accordance with AS 2101, and identifying and assessing risks of material misstatement in accordance with AS 2110.
- The standards need to be clear about what is meant by “the scope of the work to be performed by the other auditor” and how this influences the way in which lead auditors and other auditors communicate with each other during a multi-location audit.



- The focus should be on the lead auditor’s communications about the matters that will be most relevant to the work to be performed by the other auditor, its expectations regarding that work, and its judgment about whether it is necessary to review the other auditor’s planned procedures or obtain and review a description of them depending upon the lead auditor’s determination of the extent of supervision of the other auditor.
- The other auditor is expected to advise the lead auditor on a timely basis regarding any information that would affect the consolidated financial statements or cause the other auditor to recommend changes to the scope of the other auditor’s work.
- Tailored, two-way communication throughout the audit is more beneficial than potentially lengthy standardized written communications. Rather than memorializing every discussion between the lead auditor and other auditors, the focus should be on documentation of the final audit plan (including how other auditors will be involved) and the results of procedures that were performed, supported by other auditor documentation in accordance with AS 1215.19.
- When the lead auditor and other auditor have a common methodology, that understanding of the procedures the other auditor would perform can be leveraged and communications focus on any areas where the other auditor may consider it necessary to deviate from methodology and the reasons why.

We agree that the lead auditor must take responsibility for the identification and assessment of the risks of material misstatement of the consolidated financial statements, as well as the nature, timing, and extent of further audit procedures to be performed to appropriately respond to those risks. In scoping the multi-location audit, the lead auditor performs initial risk assessment procedures and identifies risks of material misstatement at the consolidated financial statement level, which ultimately results in the identification of significant accounts and disclosures and their relevant assertions in accordance with AS 2110.59. The lead auditor then develops the audit plan, including the proposed scope of audit procedures to be performed at locations or business units and the extent to which other auditors will be involved. This initial scoping process and risk assessment by the lead auditor should form the basis for further communications with other auditors, with the goal of helping them understand how their work supports the consolidated financial statement audit and guide them effectively as they perform work at the location or business unit.

When an other auditor is requested to perform a full scope audit or an audit of a specific account balance at a location, and the lead auditor is satisfied as to the other auditor’s knowledge, skill, and ability, we believe the other auditor is then best placed to perform the detailed risk assessment for the respective location or business unit and develop appropriate responses to those risks. In many instances, the other auditor of a location or business unit is better suited to identify likely sources of potential misstatement due to its knowledge of a component’s specific systems and processes, information technology infrastructure, and regulatory environment, among other matters. This exercise may involve the performance of additional risk assessment procedures to supplement the lead auditor’s risk assessment and may, in certain instances, result in the identification of additional significant risks of material misstatements that should be communicated to the lead auditor.

In our previous feedback on the 2017 supplemental request for comment, we agreed that it is important for the lead auditor to communicate to other auditors its views on *significant* risks that have been identified and other potential risks of material misstatement that may be relevant to the other auditor’s work. We understand, supported by review of page 32 of the release, that the PCAOB has not limited 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.” Requiring the lead auditor to communicate all identified risks of material misstatement to the consolidated financial statements that are applicable to the location or business unit may not necessarily fully alleviate the PCAOB’s concern, in particular if the information is not appropriately considered and acted upon by the other auditor.



Rather, we believe it is necessary for the communications between the lead auditor and other auditor to be appropriately tailored based on the work that the other auditor is tasked to perform and the lead auditor's determination of the extent of supervision of the other auditor. We support a requirement that focuses on the lead auditor supplementing the communication about identified significant risks to the consolidated financial statements with communications about other matters that would assist the other auditor in developing a more granular view of risks specific to the location or business unit in circumstances when the other auditor is performing a full scope audit or an audit of one or more specific account balances (e.g., about judgments made by the lead auditor in scoping the multi-location audit). When the other auditor is performing specific procedures designed and communicated by the lead auditor, it is less likely there would need to be communications beyond the significant risks.

For example, to acknowledge the importance of the lead auditor providing the other auditor with context around the proposed scope of its work, we have proposed requiring that the lead auditor communicate the "significant accounts and disclosures within the consolidated financial statements that are relevant to the work to be performed by the other auditor." In practice, we would expect the communications with other auditors to provide relevant information to assist them in effectively performing the scope of work requested by the lead auditor - leveraging the factors described in AS 2110.12.

The lead auditor's communications would also make the expectation clear that communications from other auditors identify matters that may be relevant to the lead auditor's assessment of risks of material misstatement to the consolidated financial statements. For example, consistent with practice today, when the other auditor performs additional risk assessment procedures in support of the audit of the consolidated financial statements, the other auditor communicates any incremental significant risks of material misstatement identified by the other auditor.

Description of audit procedures to be performed by the other auditor

Proposed AS 1201.09 would require the lead auditor to obtain and review a written description of the audit procedures to be performed by the other auditor based on the scope of the work communicated by the lead auditor, 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. In practice today, lead auditors apply professional judgment in determining the nature and extent of review of the other auditor's audit strategy and audit plan, including potentially reviewing the procedures to be performed by other auditors). This judgment is based on the nature of the work being performed by the other auditor and risk characteristics that relate to both the:

- Location or business unit (e.g., the relative significance of the size and risk of the location or business unit to the consolidated financial statements); and
- Other auditor (e.g., the assessment of the knowledge, skill, and ability of the other auditor).

While we appreciate and agree with the language in the requirement that explains that the level of detail of this description would be determined based on the necessary extent of supervision of the other auditor's work, we remain concerned that this requirement is overly focused on obtaining written documentation rather than engaging with other auditors on the most significant judgments made in performing work at a location or business unit.

We agree it is necessary for the lead auditor to take responsibility for the nature, timing, and extent of the work to be performed by other auditors. However, we do not envision it would be necessary for the lead auditor to review a written description of the other auditor's planned procedures in all cases. We believe taking a more



principles-based approach to communications with other auditors would enhance quality by enabling lead auditors to more effectively tailor their communications based on the facts and circumstances:

- For example, when the other auditor is to perform a full scope audit, and both firms are part of the same network with common policies and procedures (including a common methodology), the lead auditor would already have an understanding of the procedures the other auditor would be required to perform in accordance with the network's methodology. Discussion throughout performance of the audit would focus on any areas where the other auditor may consider it necessary to deviate from that methodology and the reasons why.
- Similarly, scalability within the requirements is necessary to take into account the lead auditor's previous experience with the other auditor. For example, when an other auditor is first engaged to perform work at a location or business unit, the lead auditor may determine that a more detailed discussion of the other auditor's audit strategy and audit plan, including risk assessment and audit procedures planned to respond to those risks, is needed in the initial year. This may be particularly true when dealing with a new other auditor who is not a member of the same network. Subsequent to that first year, the lead auditor may focus more closely on changes in the other auditor's plan. The same would be true when the other auditor is to perform an audit of a specific account balance at a location or business unit. On the other hand, if a lead auditor requests an other auditor to perform specified procedures on certain accounts or disclosures, it would be unnecessary for the other auditor to provide a written description of procedures.
- In practice, we often find it more effective to engage directly with other auditors, for example through in-person or virtual site visits or other discussions, rather than detailed written communications. This may assist in improving communications, detecting potential problem areas, enhancing the lead auditor's knowledge of the client's overall business, as well as the location or business unit (and its management), and building substantive relationships with clients both at the head office and at locations or business units.

Assuming the lead auditor is satisfied with the knowledge, skill, and ability of the other auditor as required by paragraph .06H of AS 2101, senior members of the other auditor engagement team would assist the lead auditor with responsibilities for planning and supervision. This would include reviewing the planned nature, timing, and extent of procedures to respond to the assessed risks of material misstatement at the location or business unit. This appears consistent with the PCAOB's statement on page 49 of the 2016 proposal that "the lead auditor generally has better visibility of the entire audit and the other auditors have more detailed information than the lead auditor about audit areas in which they are involved."

Access to and review of other auditor workpapers

An important aspect of the lead auditor's supervision is review of relevant audit documentation. We support up-front consideration of whether the lead auditor will be able to gain access to the other auditor's documentation. Proposed AS 1201.12 would require the lead auditor to direct the other auditor to provide specified documentation concerning work to be performed based on the necessary extent of its supervision of the other auditor's work. We agree with the discussion on pages 35-36 of the release that explains that in some, but not all, cases review of additional documentation beyond the items listed in AS 1215.19 may be necessary. We generally support the changes made to AS 1201.12 since the 2017 supplemental request for comment to acknowledge the lead auditor's use of a risk-based approach in determining which specific documentation to review (including whether to review other auditor workpapers). However, it is important to acknowledge the challenges that occur in practice today with the other auditor "providing" certain audit documentation to the lead auditor. Privacy laws in certain jurisdictions may create obstacles for the transfer of the other auditor's documentation from the country in which the other auditor is located to the lead auditor's country. The increased use of technology, including virtual



meetings, has helped us overcome some of these challenges. We believe the proposed requirements should allow for a more principles-based approach to reviewing other auditor documentation beyond AS 1215.19. In our view, a “review” can be fundamentally completed without physically or electronically obtaining the workpapers subject to that review. The lead auditor might also visit the location of the other auditor or discuss with the other auditor the procedures performed, the evidence obtained, and the conclusions reached by the component auditor.

We suggest focusing on coordination between the lead auditor and other auditors, manifested in the other auditor’s agreement to perform the work requested by the lead auditor and confirmation that the lead auditor will be able to gain access to the other auditor’s documentation. We agree that the other auditor should continue to provide documentation in accordance with AS 1215.19, and that the lead auditor determine whether, and the extent to which, it is necessary for the lead auditor to review additional parts of the other auditor audit documentation, if any, beyond what is required by AS 1215.19, taking into account the two-way communication that has occurred throughout the audit.

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?

We support both the PCAOB’s intent to clarify the supervision requirements for multi-tiered audits and the principle that the lead auditor may seek assistance from a first other auditor in fulfilling certain planning and supervisory responsibilities of the lead auditor with respect to one or more second other auditors. However, as drafted, we have concerns that the proposed requirements do not sufficiently reflect this principle, which may result in practical challenges.

In a multi-tiered audit, first other auditors are required to perform their work in accordance with PCAOB standards and therefore should apply all requirements in both AS 2101 and AS 1201 when they intend to use **second** other auditors. Accordingly, we are of the view that the lead auditor should be allowed to rely on the first other auditor’s work to a greater extent than the proposed requirements currently allow. We also believe it would be more clear to incorporate guidance explaining how the core requirements would be applied in multi-tiered audits as illustrated in Appendix 2, rather than establishing separate requirements as originally proposed.

Definition of multi-tiered audits

We do not believe that the proposed definition of multi-tiered audits, as outlined within proposed footnote 19 of AS 2101, provides sufficient context for the circumstances that may give rise to such audits. Currently, the definition appears to focus on instances when an other auditor assists the lead auditor in supervising a second other auditor or multiple second other auditors. We believe that the *structure* of the audit, and not entirely the nature of the review (as implied by the “e.g.,” portion of the definition), is likely more important to defining the concept of a multi-tiered audit. For example, a multi-tiered audit may exist even if the first other auditor does not assist the lead auditor in supervising the work of a second other auditor. We believe the characterization of multi-tiered audits in the 2017 release is more appropriate in explaining what is foundational to multi-tiered audits, and accordingly propose an update to the definition in footnote 19 in Appendix 2.

Extent of supervision and description of the scope of the second other auditor’s work

As written, the proposed requirements do not appear to allow for a first other auditor to assist in determining the extent of supervision of the second other auditors’ work in accordance with proposed paragraph .06 of AS 1201. We do not believe this is the PCAOB’s intent, based on language in footnote 102 of the release. As the first other auditor makes the judgment to use a second other auditor in performing the work requested by the lead auditor



(e.g., at sub-locations or business units), the first other auditor will often be in the best position to scope the work and determine the extent of supervision of the other auditor.

Additionally, a requirement for the lead auditor to obtain and review a written scope of work for each location or business unit in multi-tiered structures is a significant change from current practice and may be difficult to apply in audits that include many different locations and auditors. This may detract from the lead auditor's capacity, and divert its focus away from areas of highest risk. However, we agree the lead auditor should have an understanding of how second other auditors are used to consider whether, and if so, the extent to which the lead auditor should be involved in the work of the second other auditor, and also to comply with Form AP requirements.

In our view, there should be two-way communication between the lead auditor and the first other auditor when the first other auditor intends to use a second other auditor. The lead auditor should understand what the first other auditor has communicated to the second other auditor, including the scope of the work expected to be performed by the second other auditor, and the first other auditor's determination of the necessary extent of supervision of the second other auditors. In some but not all cases, the lead auditor may separately determine it is necessary to be involved in the work of the second other auditor (including review of the other auditor's documentation in accordance with AS 1215.19). This can occur, for example, based on the significance of the work the second other auditor is asked to perform. We suggest additional language to reflect the permissibility of this approach in paragraph .06Ad of AS 2101 and paragraph .08d3 of AS 1201 in Appendix 2.

Evaluation of the first other auditor's supervision

We support the proposed requirement in paragraph 15 of AS 1201 as we believe the lead auditor may not consider it necessary to separately review work performed by the second auditor. This is because, as acknowledged in the note to paragraph 14, the second other auditor's work may be incorporated into the first other auditor's documentation that is reviewed by the lead auditor. However, proposed paragraph .14 of AS 1201 would require the lead auditor, in supervising the first other auditor, to "evaluate the first other auditor's supervision of the second other auditor's work." We are unclear how such a requirement would be operationalized, in particular what would be taken into account in making this evaluation. As discussed in our response to question 7, the supervision of an other auditor throughout the multi-location audit is an iterative process. We believe up-front discussion between the lead auditor and first other auditor about how second auditors will be used and supervised would be more beneficial to audit quality. Because it may not always be possible for the lead auditor to observe the nature and extent of the review performed by the first other auditor, we also believe that the written affirmation obtained by the lead auditor from the first other auditor in accordance with new proposed paragraph .11 of AS 1201 should, as applicable, affirm the supervision of any second other auditors as agreed to with the lead auditor (see Appendix 2). Our drafting suggestions in paragraphs .08 and .09 of Appendix 2 reflect these views.

- 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?**

We agree the language related to multi-tiered audits in paragraph .06Ac is clear and appropriate.



We support the PCAOB's intent to clarify the planning requirements for multi-tiered audit scenarios and agree that first other auditors are often best suited to perform the planning procedures related to the second other auditor's qualifications. However, similar to our response to question 8, we are concerned with how the requirements are presented, in particular their placement. We suggest deleting the requirement in paragraph .06I of AS 2101 related to assessing the knowledge, skill, and ability of other auditors and positioning it as a note to the requirement in paragraph .06H of that standard, and noting that the first other auditor would be expected to communicate any concerns about the second other auditors' knowledge, skill, and ability to the lead auditor.

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

We support the PCAOB's proposal to retain a model that provides auditors with the ability to divide responsibility with other auditors in an audit of financial statements and, if applicable, internal control over financial reporting. We also support the PCAOB's efforts to specifically address requirements for divided responsibility in the proposed new standard AS 1206. We believe that the modifications proposed in AS 1206 are clear.

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?

We are supportive of the Board's decision to no longer require the investor's auditor to supervise the investee's auditor's work in accordance with AS 1201. We agree that Appendix B of AS 1105 provides helpful context in evaluating the relevance and reliability of audit evidence associated with the valuation of investments based on investee financial results, and that the proposed amendments to AS 1105.B1 are helpful in clarifying that the lead auditor's assessment of audit evidence associated with audited financial statements of equity method investees is not intended to classify the investee's auditor as an "other auditor."

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?

As noted in a number of responses to specific questions, we believe compliance with certain requirements could drive increased costs without a commensurate benefit to audit quality. This is particularly true when the lead auditor and other auditor are part of the same network. If lead auditors and other auditors are not able to sufficiently leverage common systems of quality control (including methodology, training, and monitoring), this will lead to increased efforts to obtain written affirmations and descriptions of audit procedures that, in our view, are likely to be unnecessary.

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.

We see no reason to exclude EGCs from applying the proposed standards.



Appendix 2

Alternative approach to presented selected requirements

Note: The following represents an alternative approach to proposed paragraphs .07-.13 of AS 1201. Revisions are not shown in marked text, but reference has been included in brackets to the original requirements. Our responses to questions 7-9 in Appendix 1 provide the rationale for these suggestions. We would be pleased to discuss with the staff in greater detail.

AS 1201, *Supervision of the Audit Engagement*

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

.06A^[new] 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.^{FNA} In accordance with paragraph .06 of this standard, the lead auditor should determine the extent of supervision of each other auditor's work by taking into account: [moved from paragraph .07 and new factors included]

- a. the nature of the location(s) or business unit(s) at which other auditors will perform audit procedures;
- b. the nature, timing, and extent of procedures to be performed by the other auditor;
- c. the knowledge, skill, and ability of each other auditor;^{FNB} and
- d. in multi-tiered audits,^{FNC} the extent to which the lead auditor plans to seek assistance from a first other auditor in determining the extent of supervision of one or more second other auditors.

Note: Regardless of the extent of supervision by the lead auditor, the other auditor remains responsible for the performance of its own work in accordance with PCAOB standards, including when using other auditors in multi-tiered audits.

FNA See AS 2101.06B and .11-12.

FNB See also AS 2101.06H.

FNC Multi-tiered audits are those in which the engagement team is organized in a multi-tiered structure, e.g., whereby a first other auditor performs work at a location or business unit that includes the financial information of a sub-location or sub-unit, and a second other auditor performs work at the sub-location or sub-unit. In these circumstances, the first other auditor may assist the lead auditor in supervising one or more second other auditors. [moved from paragraph .14, FN19, and enhanced to align more closely with the structure of an audit, as discussed in question 8]

.07 For engagements that involve other auditors, paragraphs .08-.10 further describe procedures to be performed by the lead auditor with respect to the supervision of work of other auditors, in conjunction with the required supervisory activities set forth in this standard. The requirements in paragraphs .08-10 supplement the requirements in paragraph .05 of this standard and take into account the lead auditor's determination of the extent of supervision of other auditors in accordance with paragraph .06A.

Note: In multi-tiered audits, the lead auditor may seek assistance from a first other auditor in performing the procedures in paragraphs .08-.10 with respect to one or more second other auditors, if appropriate pursuant to the factors in paragraph .06A. [moved from paragraph .14, as discussed in question 8]

.08 In accordance with AS 2101, in an audit that involves other auditors, the lead auditor determines 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.^{FND} This includes assessing the risks of material misstatement to the consolidated financial statements and identifying significant accounts and disclosures and their relevant assertions based on the consolidated financial statements.^{FNE} The nature, timing, and extent of communications between the lead auditor and other auditor may vary depending on the engagement responsibilities envisaged for the other auditor. Communicating information between the lead auditor and other



auditors is part of an iterative process throughout the audit and should address: [new introduction to align with requirements in other standards as discussed in question 7]

a. Matters determined by the lead auditor:

1. The scope of the work to be performed by the other auditor; [previously paragraph .08a]

Note: The other auditor may be asked to perform an audit of the entire financial information of the location or business unit, an audit of certain accounts and disclosures of the location or business unit, or specified procedures on certain accounts and disclosures of the location or business unit. [new]

2. The identified significant accounts and disclosures within the consolidated financial statements that are relevant to the work to be performed by the other auditor; [new]
3. The identified significant risks of material misstatement to the consolidated financial statements that are relevant to the work to be performed by the other auditor; [previously paragraph .08b(1), but revised to focus on significant risks]
4. When applicable based on the scope of work to be performed by the other auditor, matters that are relevant to the other auditor's design or performance of risk assessment procedures at the location or business unit; [new]
5. Tolerable misstatement;⁶ and [previously paragraph .08b(2)]
6. The total (if determined) below which misstatements are clearly trivial and do not need to be accumulated.⁷ [previously paragraph .08b(3)]

b. Matters identified by the other auditor applicable to the location or business unit that are relevant to the lead auditor's identification and assessment of the significant risks of material misstatement to the consolidated financial statements [new]

c. Matters that are relevant to the design or performance of audit procedures at the location or business unit, including circumstances that may indicate changes to the other auditor's planned audit procedures are necessary [incorporates elements of paragraphs .09-.10]

Note: The determination of the necessary audit procedures to be performed by an other auditor at a location or business unit may be made by the lead auditor, the other auditor, or a combination of both. For example, an other auditor may perform risk assessment procedures and develop responses to assessed risks of material misstatement to the location or business unit. Depending on the lead auditor's determination of the extent of supervision of the other auditor, the lead auditor may find it necessary to discuss the other auditor's planned procedures or obtain and review a description of them.

d. Cooperation between the lead auditor and the other auditor, including:

1. agreement that the other auditor will perform the work requested by the lead auditor; [new]
2. agreement that (1) the lead auditor will be able to communicate with the other auditor, (2) the other auditor will provide documentation in accordance with AS 1215.19 to the lead auditor, and (3) other documentation, as determined necessary by the lead auditor, will be made available and accessible to the lead auditor;⁴¹ and [moved from paragraph .12, as well as paragraph .06Hc of AS 2101]
3. in multi-tiered audits, when the lead auditor plans to seek assistance from a first other auditor, discussion of the first other's auditor's:



- a. communications to any second other auditors in accordance with paragraph .08a, including the scope of the work expected to be performed by any second other auditors; and
- b. planned extent of supervision of the second other auditors in accordance with paragraph .06A.

Note: Depending on the extent of supervision of the other auditor, the lead auditor may find it necessary to communicate, or request that the other auditor communicate, the matters in paragraph .08 in writing (e.g., by issuing instructions to the other auditor). Regardless of the method of communication, the audit documentation of the lead auditor includes an appropriately detailed record of the communications with other auditors and any follow-up and disposition of matters communicated by the other auditors that meet any of the criteria in this paragraph.

FND See AS 2101.11-12.

FNE See AS 2110.64.

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

17 See AS 2810.10-.11.

⁴¹See, e.g., AS 1201.05 and .10, 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.

.09 [previously .11] The lead auditor should:

- a. obtain and review a written affirmation as to whether the other auditor has performed the work agreed with the lead auditor in accordance with paragraph .08, including affirming to the work being performed in accordance with 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 as agreed, including (if applicable) a description of the alternative work performed; and
- b. review documentation related to the work performed by other auditors as referred to in paragraph .08d(2).
[moved from paragraph .12]

Note: In multi-tiered audits, the first other auditor's written affirmation would cover its supervision of any second other auditors as discussed with the lead auditor in accordance with paragraph .08d(3), including, as applicable, review of its work. If the first other auditor is assisting the lead auditor in supervising the second other auditor, the lead auditor takes 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. [moved from paragraph .14]

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 information related to the second other auditor's work in the first other auditor's documentation that it provides to the lead auditor pursuant to AS 1215.19. [moved from paragraph .14]

.10 [previously .13] The lead auditor should determine, based on a review of the documentation made available by the other auditor (pursuant to paragraph .09), discussions with the other auditor, and other information obtained by the lead auditor during the audit, including whether:

- a. the other auditor has performed the work agreed with the lead auditor in accordance with paragraph .08, including the use of applicable PCAOB standards; and
- b. 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.



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November 30, 2021

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street N.W.
Washington, D.C. 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 042 – Release No. 2021-005

Dear Office of the Secretary:

RSM US LLP appreciates the opportunity to offer our comments on PCAOB Release No. 2021-005, *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* (the proposal).

As companies' global operations have grown, the roles of other auditors in audits have become more substantial. It is important that the lead auditor adequately plan and supervise the work of other auditors. With respect to audits involving other auditors, we continue to support a risk-based supervisory approach.

We appreciate the PCAOB's thorough efforts to address the responsibilities of the lead auditor in supervising other auditors' work and to update the requirements for situations in which the lead auditor divides responsibility for the audit with another accounting firm. We believe this revised standard strengthens the role of the lead auditor and emphasizes the need for the lead auditor to supervise other auditors. However, we believe the lead auditor's role needs to stay focused on risks, and, as discussed in our comments within this letter, there are a few aspects of the proposal that potentially could dilute that focus.

Our letter addresses the questions and requests for comment in the proposal.

Questions in the proposal

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

In recent years, companies have continued to enlarge their global footprints with expansion strategies and, at the same time, have continued to make investments in their financial reporting systems. This expansion has contributed to a growing number of audits that require the use of other auditors to support the lead audit firm's audit opinion, but also has been impacted by new and improved technology that allows for more efficient and effective audits. Auditor practices related to the use of other auditors also have been affected by the increased need, and enhanced capabilities, for supervising other auditors and reviewing the audit work papers of other firms remotely.

Overall, we believe the audit profession has recognized the changing global landscape and emerging strategic endeavors that are driving more global expansion and corporate joint venture arrangements. Many audit firms have responded with increased training, improved quality control measures and enhanced utilization of innovative technology that better enables remote global audits.

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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?

Since 2017, we have seen middle market registrants transitioning their consolidation financial reporting technology to more sophisticated global enterprise resource planning (ERP) systems (such as D365) that allow for global access to all (or at least the majority) of the original transactions. If not global ERP systems, many other technologies, such as Blackline, have been adopted to allow much greater access to and visibility into the underlying transactions of the components at the corporate level. These registrant technology advancements, combined with the technology now available to auditors for remote access and review of other auditors' work, have expanded the auditor's access to client records without being physically present with an other auditor. However, it should be noted that this enhanced access to and export of data could be jeopardized to the extent that foreign jurisdictions may seek to restrict international data flows in the future.

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?

We believe the proposed definitions of "lead auditor" and "other auditor" are clear.

We note that the proposal now defines "secondee," and we are curious as to why it is necessary to define this term. Audit firms have had and increasingly will have several types of arrangements whereby they use professionals who are located in or from a different country (e.g., secondees, subcontractors, employees) to perform audit procedures. It seems that it may be confusing to define just one type of such arrangements. We believe the extent of supervision and review of such individuals should be based on the auditor's evaluation of the knowledge and skills of the individual, regardless of the type of arrangement.

If the Board believes it is necessary to define "secondee," we suggest that consideration be given to explaining why the term is necessary and how it relates to the other requirements in the standard. We also think it would be very beneficial to clarify the definition by making it more principles-based and less granular. In that regard, we note the proposed definition states that:

- A secondee is a professional employee. Our experience indicates that laws vary from country to country as to whether a secondee is an employee.
- A secondee "is physically located in another country." We are curious as to why the physical location of the professional is relevant. If secondees have access to the audit firm's systems and are supervised by the firm, does it matter where they are physically located?
- A secondee is physically located in another country "for at least three consecutive months." If the location of the professional is relevant, why is the length of their stay in that location relevant? Would a stay in another country of two months mean that the individual is not a secondee? If the individual is not a secondee, would that change how the individual is supervised?

Also, we observed that the definition of "secondee" currently is in a footnote to a note below paragraph .A4.b(2) in Appendix A, "Definitions," of PCAOB Auditing Standard (AS) 2101, *Audit Planning*. We suggest that, if the definition of "secondee" is relevant to the interpretation of the definition of "lead auditor," it should be elevated to be included in the definition or in a note below the definition. If the definition of "secondee" is not relevant to the definition of "lead auditor," we suggest it be removed.

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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?

We agree with the proposed addition of paragraph .06A.c. to AS 2101. We agree that the engagement partner should take into account the extent of the firm’s supervision of other auditors’ work in determining whether the participation of their 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. However, we believe related footnote 4B should be revised to reference AS 1201.07, instead of AS 1201.06. Although we acknowledge that AS 1201.07 directs the lead auditor to determine the extent of supervision of the other auditors’ work in accordance with AS 1201.06, we think it is important for the lead auditor to refer to AS 1201.07 to also see its reference to the additional procedures to be performed by the lead auditor with respect to the supervision of the work of other auditors in AS 1201.08 - .15.

We continue to believe that the concept of “importance” already is factored into the auditor’s consideration of the risks of material misstatement associated with the portion of the financial statements audited by the lead auditor as required in proposed paragraph .06A.b. of AS 2101. Including importance as an additional consideration in paragraph .06A.a. of AS 2101 would be confusing to apply in practice because “importance” is not defined in the auditing standards; whereas, the consideration of the risks of material misstatement is a familiar concept for auditors and is well supported by the auditing standards. We therefore suggest that proposed paragraph .06A.a. of AS 2101 be deleted. If this paragraph is not deleted, we suggest that “importance” be clearly defined.

In determining whether the participation of their 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, we believe the engagement partner also should take into account whether the firm is licensed in the location where the auditor’s report will be issued.

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?

Paragraph .06D.a.

Paragraph .06D.a. requires the lead auditor to “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...”. We believe this requirement would not be practical to implement for the following reasons:

- It is difficult to determine what would satisfy the threshold of “obtain an understanding” in this context. Although it is unclear what “obtain an understanding of the other auditor’s knowledge” means, we envision that this could entail extensive inquiry of the individual at the firm who is responsible for such matters and also could require reading the firm’s policies governing such requirements, which, in many instances, could be volumes of material. We do not believe such an approach provides a benefit to investors that is commensurate with any potential improvement to audit quality resulting from, or the extensive cost involved with, performing the necessary procedures to comply with the requirement.

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- We also could envision that obtaining an understanding of the other auditor’s “experience in applying the requirements” could entail obtaining confidential information.

We believe the evaluation of the other auditor’s knowledge of and experience in applying the independence and ethics requirements is best addressed through a written statement from the other auditor affirming that such knowledge and experience is in place and sufficient with respect to the audit engagement. If the Board elects to retain the requirement for the lead auditor to obtain an understanding of the other auditor’s knowledge of and experience in applying the independence and ethics requirements, we believe it would be helpful to provide additional guidance to help the lead audit firm determine what would satisfy the threshold of “obtain an understanding” in this context.

Paragraph .06D.b(1)

Congruent with paragraphs .06D.b(2) and (3), we believe paragraph .06D.b(1) of AS 2101 should be revised to further clarify that the lead auditor’s responsibility for determining compliance with the independence and ethics requirements relates solely to the audit for which the other auditor is supporting the lead auditor, as follows (proposed additions are in bold font):

- (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 **with respect to the audit client**, and if it does not, a written description of how the other auditor determines its compliance with the requirements;

Paragraph .06D.b

Paragraph .06D.b. of AS 2101 requires the lead auditor to obtain from the other auditor and “review” written affirmations in the case of subparagraphs (1) and (3) and a written description in the case of subparagraph (2). We suggest consideration be given to clarifying whether there is a specific action contemplated by a “review” of an affirmation, versus a “review” of a description. Also, we suggest consideration be given to changing the requirement for “review” to “evaluate” as we believe this may be more descriptive of the lead auditor’s responsibilities in this context.

Paragraph .06E

We believe it is unclear as to how “the first other auditor may assist the lead auditor” as contemplated by paragraph .06E. of AS 2101, especially given the last sentence in that paragraph, which makes it clear that the lead auditor remains responsible for determining compliance. We suggest clarifying guidance be added to paragraph .06E as to how the first other auditor could assist the lead auditor in performing the procedures described in paragraph .06D.

Paragraph .06F

Paragraph .06F of AS 2101 indicates that the lead auditor would be required to investigate the other auditor’s basis for affirming its compliance with the independence and ethics requirements if the lead auditor becomes aware of contradicting information. This proposed requirement does not indicate how the lead auditor would perform such an investigation. We could envision that, in such scenarios, the lead auditor would need to require the cooperation of the other auditor in order to perform an effective investigation. Doing so could require the other auditor to provide information that it very likely would consider to be confidential, thereby potentially making the investigation ineffective. We believe it may not be practical to expect that a firm outside the network of the lead auditor (and, in some cases, within the same network due to local privacy requirements) would provide such confidential information to the lead auditor. Such limitations make investigations in this regard difficult to conduct.

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We suggest paragraph .06F of AS 2101 be revised as follows (proposed additions are shown in bold font, and proposed deletions are struck through):

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 **bring such information to the attention of the other auditor. The lead auditor should then evaluate the sufficiency of the other auditor's response to such information** ~~investigate the circumstances~~ and consider the reliability of the affirmation or description. If, after such **evaluation** ~~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 **with respect to the audit client**, the lead auditor should consider the implications for determining compliance with those requirements pursuant to paragraph .06b of this standard.

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?

We believe the proposed amendments relating to the knowledge, skill and ability of the other auditor, as revised by Release No. 2021-005, generally are reasonably clear and appropriate. However, we believe consideration should be given to allowing the lead auditor's procedures with respect to the knowledge, skill and ability of other auditor to be scalable based on a risk assessment, taking into account the considerations in paragraph .06A of AS 2101. In other words, the need to gain an understanding regarding the knowledge, skill and ability of the other auditor would increase in situations where there is greater importance of locations, more risks of material misstatement or less supervision of the other auditor's work. For example, we believe the lead auditor's procedures with respect to the knowledge, skill and ability of an other auditor who audits 40 percent of the company's assets or revenues should be different than those related to an other auditor who audits 8 percent of the company's assets or revenues.

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

Paragraph .09

Proposed paragraph .09 of AS 1201 requires the lead auditor to "Obtain and review the other auditor's written description of the audit procedures to be performed..." We believe this proposed requirement would involve the performance of a review at a level of detail that may not be necessary or effective in all circumstances. For example, it may not be necessary for the lead auditor to obtain the entire audit program from the other auditor when the other auditor performs a full-scope audit and uses a common set of network-provided tools and methodologies.

We believe a more effective and efficient risk-based approach would instead be limited to requiring the lead auditor to obtain and review the other auditor's description of the nature, timing and extent of audit procedures to be performed in response to identified risks of material misstatement that are applicable to the location or business unit. In addition, we believe the lead auditor also could use the

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results of its procedures performed regarding the knowledge, skill and ability of the other auditor to inform its determination of the necessary review of the other auditor's procedures to be performed.

Paragraph .10

Proposed paragraph .08 of AS 1201 requires the lead auditor to "Inform the other auditor in writing of...the identified risks of material misstatement to the consolidated financial statements that are applicable to the location or business unit." We agree that this initial communication with respect to the work requested to be performed should be in writing, and that the other auditor should communicate the results of final procedures performed in writing to the lead auditor as prescribed by proposed paragraph .11 of AS 1201.

However, because the identification of risks of material misstatement is an iterative process that continues until completion of the audit, after the initial written communication of planning matters, the lead auditor continues to communicate with the other auditor at various points throughout the audit regarding such risks and other matters related to the audit. We note that, in practice, the nature of the matter to be communicated and other factors will influence the auditor's professional judgment in determining which method of communication (e.g., phone call, video conference, email) is most appropriate and effective for such subsequent communications with the other auditor.

We therefore believe that proposed paragraph .10 of AS 1201 may be overly prescriptive in its requirement for the lead auditor to discuss with, *and* communicate in writing to, the other auditor any changes to the other auditor's planned audit procedures. We are concerned that this requirement to communicate such matters via two communication methods may create added administrative and cost burdens that don't improve audit quality. We believe it would be more effective to allow the lead auditor to apply professional judgment in determining whether such subsequent communications of changes to the other auditor's planned audit procedures should be made in writing or orally.

- 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?***

We believe the proposed requirements for multi-tiered audit 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 are clear and appropriate. If properly planned and supervised, these proposed requirements should enhance overall audit quality.

- 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?

We believe the proposed requirements for multi-tiered audit planning are clear and appropriate regarding (a) the sufficiency determination relative to the extent of the engagement partner's firm's

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supervision of the other auditors' work 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).

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

We believe the modifications in proposed AS 1206, including Appendix B, to reflect the auditor's report language in AS 3101 are appropriate and clear.

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?

We believe the proposed amendments to AS 1105.B1 to guide auditors in equity method investment circumstances are clear and appropriate. We concur that the investor's auditor should not be required to supervise the work of the investee's auditor under AS 1201. We agree that, instead, the investor's auditor should look to the requirements of Appendix B of AS 1105 for 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.

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?

We are not aware of other data sources the Board should consider in establishing the baseline for evaluating economic impacts, or additional academic research papers or external reports of which the Board should be aware.

We believe some of the proposed requirements will result in increased audit fees for registrants. For example:

- The proposed standard makes no distinction between the supervisory requirements for other auditors from the same global network of firms as the lead auditor and those for other auditors outside the network. We believe that, when network firms participate in the audit, this lack of differentiation could create additional effort that would not improve audit quality and would result in additional costs for the audit client. For example, because the proposed standard ignores a network firm's system of quality control that is operating effectively, there could be duplication of effort between the lead auditor and the other auditor, especially related to evaluating independence, technical training and the performance of members of the engagement team.
- Proposed paragraph .09 of AS 1201 requires the lead auditor to "Obtain and review the other auditor's written description of the audit procedures to be performed..." We believe this proposed requirement, among others, could cause an other auditor that is not a member of the lead auditor's network to be concerned about the confidentiality of its audit methodology. This, in turn, could cause a registrant to need to engage other auditors that are part of the same network as

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the lead auditor, resulting in (a) incremental fees in changing audit firms or (b) the performance of duplicate work by two audit firms – one that has the statutory appointment and one that is reporting to the lead auditor as an other auditor.

Requests for comment in the proposal

V. *Special considerations for audits of emerging growth companies*

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.

We believe the proposed amendments should be applicable to all issuers, regardless of size, in order to protect investors. Given the complexities involved in global operations and the use of other auditors, we believe it is appropriate for the Board to request that the SEC determine that it is necessary and appropriate to apply the amendments to audits of emerging growth companies.

VI. *Application to audits of brokers and dealers*

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.

We do not believe the revisions discussed in the release present specific issues with respect to audits of brokers and dealers.

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 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).

If finalized, the proposed new auditing standard and amendments will require that audit firms spend a considerable amount of time to develop and implement effective quality control procedures and related training. Also, the new requirements likely will require extensive discussions with other auditors as implementation of the new requirements is evaluated. Due to the extent of these efforts, we believe it would be prudent for the proposed new auditing standard and amendments to be effective for audit periods ending two years after the SEC approves the final standard, regardless of the calendar quarter in which the final standard is approved.

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We would be pleased to respond to any questions the Board or its staff may have about our comments. Please direct any questions to Adam Hallemeyer, Audit Policy Leader, at 619.641.7318 or Sara Lord, Chief Auditor, at 612.376.9572.

Sincerely,

RSM US LLP

RSM US LLP

Office of the Secretary, PCAOB

November 28, 2021

1666 K Street, NW,

Washington, DC 20006-2803

Cf. P.C.A.O.B. Rulemaking Docket Matter 042

Dear P.C.A.O.B. Secretary :

While it is a privilege to be able to comment on P.C.A.O.B. Release 2021 – 05, “Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Accounting Firm”, the present commenter has reviewed P.C.A.O.B. Release 2021 – 05 and related releases and standards in considerable detail. This release appears to break new ground as it replies by its language to a number of audit quality topics that have been matters of official discussion over time. This commenter must mention here that where this Release 2021 – 05 deals with the topic of other auditors, it is clear in most cases by this release what the practice is concerning the additional auditor, though for some a more complicated scenario awaits given independence rules and multi – tiered financial statement audits. This commenter has re – printed the question stem in front of answers to questions for the convenience of the reviewer.

Questions:

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

Answer : The independent oversight of the P.C.A.O.B. of public company audits and SEC - registered broker - dealers, its emphasis and enhancement of the roles of audit committees and corporate governance; and an emphasis on transparency, executive accountability and investor protection as well as enhancing the importance of auditor independence have continued to be important elements of the Sarbanes - Oxley Act since 2002. The establishment of the P.C.A.O.B. and its role in the supervision of audit firms is the bedrock of these elements. The P.C.A.O.B. continues to set auditing and related professional practice standards and rules, and continues to carry on inspections concerning audit and governance quality control vis - a - vis its standards with oversight sanctions in view of compliance with its standards. The P.C.A.O.B. has more recently made efforts to make its practices and processes more transparent given inspections and quality control findings that include a Remediation Framework (Change, Relevance, Design, Implementation, and Execution and Effectiveness of remedial corrective steps for those under examination) that invites root cause analysis of deficiencies, and that influences and enhances the design and execution of remediation activities before the Board. These have resulted in more proper improvements to audit quality and a noticeable decrease in adverse inspection findings over time. The P.C.A.O.B. has also enhanced the role of company boards and audit committees that has resulted in increased emphasis and authority of proper corporate governance. Part of this is due to the independence requirement for company board members from entity management. This dovetails with the elements of enhanced transparency, investor protection and company executive accountability of the business for the financial statements through the CEO and CFO. Further, while ICFR (Internal Control

over Financial Reporting) and its evaluation have been a subject of discussion and significant examination findings over time, there has been significant remediation of deficiencies in this area to improve the quality of public company audits in recent years. This has been the result of SEC and P.C.A.O.B. monitoring, outreach and issuer support, and resulting remediation to enhance the fair presentation, relevance and reliability of corporate financial statements.

The P.C.A.O.B. has also worked to remediate and enhance auditor independence and objectivity to protect investors and to increase investor confidence over time. An original example of this has been the limitation on non - audit services by audit firms. More recent efforts addressing independence and objectivity have included increased importance of audit committee governance and its practices, rotation of key audit partners and changes in engagement and concurring partners every five years, and other audit partners every seven years. These requirements have invited an increased importance of the independence rules and a more careful application thereof that include various efforts to keep the principal audit stakeholders current and educated on audit issues. With respect to this and the aforementioned developments, the P.C.A.O.B. is and was an original audit oversight organization, unique and individual to the U.S. and its public companies and auditors while it now has many allied bureaus and administrative bodies internationally. Given that the U.S. business environment is constantly changing and the world business environment as well, the Board has engaged the use of data analytics, automation and information processing, has encouraged developments in corporate reporting that include new and innovative approaches to new technologies, investments, management decisions and policy, segment reporting, and sustainability, the environment, society and governance developments as well. The increased emphasis on the entirety of a corporate dataset versus traditional sampling, new technologies, the work of specialists, innovative accounting and auditing approaches assure the development of new P.C.A.O.B. standards that allow for Board research and stakeholder input and feedback that will improve the overall quality of Board standards and of financial statement audits thereby. It appears the Board will continue to emphasize the importance of audit quality as well given the development of better audit firm quality control systems that promise to become a focus of future Board examinations of audit firms.

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? **Answer :** To cite Steven B. Harris from an April 20, 2017 talk at the P.C.A.O.B. annual meeting [the economics and utilities of business and industry and financial reporting practices as well as economic conditions have invited] “technological advances in areas such as artificial intelligence, robotics, the Internet of Things, autonomous vehicles, 3-D printing, nanotechnology, biotechnology, and quantum computing — just to name a few — [that] could transform every industry in every country... This perspective has been embraced by the leadership of the major accounting firms as it relates to the use of technology in the conduct of an audit. According to a recent report, the accounting profession spends approximately \$3 billion to \$5 billion a year on technology and it is now part of the new baseline of operational costs for the major firms” Data analytics have enabled auditors to examine the entirety of a company’s unstructured dataset instead of a reliance upon traditional precision sampling. This allows the testing of one hundred percent of a company’s data, and the technological tools and developments are not necessarily confined to data mining and analysis : Process automation, greater precision in the examination of data and metadata, improved fraud detection methods and processes commensurate with enterprise big data. This requires the data to be secure, accurate, complete and reliable and passable given quality control measures. Analysis tools must be consistent in their approach to these large datasets and given this the role of internal audit and audit quality is enhanced by this requirement. Predictive analytics also has a role in the extraction, compiling and analysis of data

insofar as systemic and management learning, strategy and policy development are concerned. These tools and their effect upon the circumstances of companies and the work performed by auditors changes the nature and character of the accounting transaction in that these are now more meaningful and valuable to company management and will result in important changes to financial reporting practices, laws and regulations.

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? **Answer** : Given references to AS 1201 and AS 2101, AS 1206 and definitions given in Release 2021 – 05 and corresponding documentation, the definitions of “lead auditor”, “other auditor” and “referred – to auditor” do appear to be clear for purposes of Docket 42.

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? **Answer** : The criteria and considerations of sufficiency of participation and the locations of the audited business unit(s) vis – a – vis the location of the lead auditor; consideration of qualitative and quantitative factors determining the sufficiency of participation of the lead auditor; risk(s) and importance of the audited location(s); and the role of the lead auditor as commensurate with the risk(s) of material misstatement in the audited locations (with greater involvement and participation of the auditor in greater areas of risk) are appropriate and clear per Release 2021 – 05.

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? **Answer** : The P.C.A.O.B. seeks to establish and to maintain the highest quality auditing and professional and related practice standards of independence, integrity and objectivity. The purpose of this is to maintain the highest standards of ethical conduct and to provide the public and other stakeholders with confidence in compliance with rules and standards including those applying to ethics. Registered public accounting firms are required to comply with such standards and rules, guidelines and practices. The overall application of AS 1201 and 1205 (and for example, Release 2021 – 05 discussion as to the role of AS 1015, AS 1105, AS 2101, and AS 2301 that establish and even strengthen the responsibilities of employee and staff stakeholders as well as those of the lead auditor) in Release 2021 - 05 with respect to the lead auditor and other auditors indicates an appropriate consideration of the responsibilities regarding other auditors’ compliance with independence and ethics requirements. The implementation and application of these different standards require assessments as to audit responsibilities at least during the planning stage(s) of the audit regarding division of responsibilities, consideration of the independence, knowledge, skill and ability of staff and employees, and planning and supervision of work and the work of other auditors and so on. This requires experience and foresight on the part of audit planners and in the due diligence process. The application and implementation of standards sets the tone for the audit that might become more diffuse as work proceeds and as audit work even occasionally demands expedient considerations that invite gray areas in evaluating how challenges of the audit are to be met and work performed in producing a proper audit work product. This is even more evident in evaluating, again, the compliance requirements of multi – tiered audits. Proper, timely

and appropriate monitoring during the performance of the audit might be enough to address these challenges, if not then “manager over shoulder” activities that enhance supervision of audit work and the production of audit work product, that are altogether less expedient and more time and effort intensive, would be required.

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? **Answer :** The engagement partner and other appropriate engagement team members are required to consider for planning and supervision purposes the knowledge, skills, and ability of participants, employees and staff, in the audit and the other auditor. P.C.A.O.B. standards call for the same criteria to be applied in this assessment to the other auditor – the same as for employees of the lead auditor’s firm who work on the audit. Assessment as to sufficiency of these criteria for working on the audit is apparently enough to carry out the responsibilities of the lead auditor who considers the risk of material misstatement and the importance of the business unit(s) covered by the firm’s audit procedures. The lead auditor also must assess whether its own participation in the audit is sufficient for it to serve as the lead auditor given work possibly performed by other auditors. This planning – stage assessment and division of responsibilities also depends upon the tone of the audit established in pre – planning and planning, due diligence and related activities preceding actual audit work and the production of audit work product. These provisions are clear and appropriate given P.C.A.O.B. Release 2021 – 05, and it is important that the professional tone of the planning and due diligence activities preceding audit work pervade the actual audit work and work product in order to avoid challenges of the quality of the audit work possibly becoming diffuse and more in need of direct monitoring and control by audit management, a more labor intensive and less expedient process.

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? **Answer :** 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 are appropriate and clear. Compliance with AS 1201 implies an entire list of procedures for the lead auditor to perform and in the direct and indirect supervision of the firm’s auditors. At the level of the procedures indicated in AS 1201 by the lead auditor, a proper monitoring and even remedial function should be implemented by audit management as to audit work, and per discretion and assessment of the lead auditor. The tone of the professional and diligent planning of the audit should carry throughout the duration of the audit in order to uphold the highest quality standards for audit work. This should consist of again if necessary “management over shoulder” monitoring and if necessary increased management guidance and supervision of audit personnel and the other auditor per discretion and assessment by the lead auditor.

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? **Answer :** There are a number of considerations in multi – tiered audits having to do with management and supervision, access and authorization as well as information and data security at different tiers in the carrying on of an audit which require communication up the audit management hierarchy, and implementation of directives directly and indirectly from audit management to audit staff and employees, etc., and from the lead partner and the engagement partner to audit staff and employees. This is also true for directives and audit

requirements for the other auditor. These considerations and the supervisory procedures in the discussion of Release 2021 - 05 for the other auditor on behalf of the lead auditor appear clear and appropriate and this commenter suggests any revision to proposed requirements should be made with consideration to possible audit control environment and with less consideration as to specific or enhanced supervision, directives or regulation by audit management.

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? **Answer** : In the event the overall audit requirements with respect to questions 9a. and 9b. are not clear and appropriate, that is to mention here, in consideration of 9a. and 9b., assessments as to sufficiency of audit work and supervision; and then the application of AS 1201 in seeking assistance from staff including from other auditors; the requirements should be revised commensurate with the assessed inherent risk and control risk of the audit and with specific respect to the status of the issuer entity control environment. This question appears to address the question of audit quality and of the quality of audit work and personnel. This commenter suggests that re – assessing inherent risk and control risk and emphasizing a stricter examination of the control environment during the audit along with increased and enhanced monitoring of audit work might help to better fulfill the spirit of these requirements to the letter if needs be. These requirements otherwise do seem to be clear and distinct, appropriate, fair and reasonable.

10. Are the modifications in proposed AS 1206, including Appendix B, to reflect the auditor's report language in AS 3101, appropriate and clear? **Answer** : The modifications in proposed AS 2106, including Appendix B, are clear and properly reflect auditors' report language in AS 3101. This is reasonable and fair, relevant with respect to reports issued that include the report mentioning a "referred – to auditor" (Examples 1 and 2,) and reports by a "lead auditor" (Examples 3 and 4.)

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? **Answer** : The proposed amendments to AS 1105.B1 to guide auditors in equity method investment circumstances are clear and appropriate and should nonetheless include more than the requirement that the auditor obtain sufficient evidence through simple evaluation of the sufficiency prima fascia of the equity investee's financial statements and results. As thorough as possible, an understanding of the equity investee's control environment might also be necessary in addition to an evaluation or assessment of prior audit risks and investee business, financial and market risks and the ways these have been managed by the investee.

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? **Answer :** This commenter is not aware of any additional information nor white papers, nor academic research papers, nor external reports of which the Board should be aware in this matter. Given the additional scale and scope of audits that involve the use of other auditors, the questions of additional economic and monetary costs and benefits of compliance arise, as well as additional costs of monitoring, planning and supervision, and of audit work itself. Though there are evidently marginally increased audit engagement costs of first asking for the assistance of and then relying on other auditors, these possibly and probably are incremental and should not interfere with overall audit quality given a priori management style and activities and the status of the entity control environment as well. There are additional considerations that affect economic costs of implementing Release 2021 – 05 insofar as more due diligence is required to review the financial statement work product of other auditors, the quality of that work product in the form of financial statements and the overall value of this given different audit methodologies and approaches, etc., of different audit firms.

Since the lead auditor will now presumably bear the responsibility for the audit that includes the work of other auditors, there is a utility cost of the other auditors possibly being less accountable and feeling less responsible for their audit work product. For consideration are the potential additional costs and benefits of this change in standards and of matters affecting the industry in which the company operates, such as financial reporting practices, economic conditions, laws and regulations, and technological changes. These additional costs, however incremental, could add up significantly and place additional economic and monetary burdens on the lead and engagement auditors.

By,

Thomas H. Spitters, C.P.A.

Thomas H. Spitters, CPA – (415)800-4499 – tom.spitters@hotmail.com

San Francisco, CA 94104, U.S.A.

November 22, 2021

PCAOB
Office of the Secretary
1666 K Street, NW
Washington, DC 20006-2803

Email: comments@pcaobus.org

RE: PCAOB Rulemaking Docket Matter No. 042

The views expressed herein are a joint response written on behalf of the Professional Standards Committee (PSC) of the Texas Society of CPAs. The committee has been authorized by the Texas Society of CPAs' Board of Directors to submit comments on matters of interest to the membership. The views expressed in this document have not been approved by the Texas Society of CPAs' Board of Directors or Executive Board and, therefore, should not be construed as representing the views or policy of the Texas Society of CPAs. Please find our responses below to the amendments proposed in the above-referenced exposure draft.

Request for Comments:

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

We have not noted any significant 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?

The recent global pandemic has affected the operations of many companies, including audit firms. International travel is in a state of constant disruption, which may lead to the use of other auditors in affected areas in order to complete audits of multinational companies.

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?

The definitions presented in the proposal are clear.

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?

The proposed considerations regarding the lead auditor's role in performing an audit are clear as presented. However, the proposed responsibilities may not be appropriate. The PCAOB appears to be shifting the regulatory responsibility to the auditor. Where previous guidance relied on the judgment of primary auditor with regards to the use of other auditors, the PCAOB seems to be adding this prescriptive requirement in order to impact the responsibility of the lead auditor and possibly affect future inspections. Also, there may be limitations placed on auditors by certain sovereign nations that may preclude lead auditors from exercising control to the extent appropriate to accomplish the objective as stated in this proposal.

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?

We do not think that the proposed responsibilities regarding other auditors' independence and ethics requirements are appropriate. In the proposal, the lead accountant is being asked to perform regulatory duties of the PCAOB. Instead, the objective could be obtained by requiring audit firms to be registered with the PCAOB, making them subject to all PCAOB requirements. This option would allow the PCAOB to provide investors a uniform source of auditors to the investing community who can be used interchangeably as lead or other auditors. Lead auditors and investors would have the full faith and commitment of the PCAOB under this type of arrangement. Appropriate records of registration with the PCAOB would become a routine part of the inspection process.

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?

Again, while the proposed amendments are clear, they may not be appropriate. Allowing only firms registered with the PCAOB to participate in audits of public companies will assure lead auditors of compliance with PCAOB standards when using other auditors. The standards of the PCAOB are clear and well written, providing a basis for consistent application for firms registered with the PCAOB. The proposed amendments could be modified to require all entities engaged in a public entities assurance engagement to be registered entities. This requirement would be subject to PCAOB review and provide additional confidence to investors.

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?

The proposed amendments are clear. However, the proposal would require the lead auditor to supervise the other auditor as if they were the lead auditors' employees. This may require smaller firms to hire additional staff to be able to complete the audit work instead of utilizing outside auditors. The proposal may also result in scope limitations in certain jurisdictions that prohibit U.S. firms from performing audit work if lead auditors are unable to locate other auditors who will meet these proposed requirements.

8. In multi-tiered audits, are the proposed requirements for situations in which the lead auditor directs another 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?

The proposed requirements are clear. However, additional guidance on the type of firm that can be used internationally would be beneficial to the lead auditor. The additional guidance should include peer or regulatory review requirements of the other auditor. This additional guidance would provide the lead auditor confidence that firms being utilized are held to objective, verifiable and reliable international standards that are monitored by agencies such as the PCAOB.

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?

The standards as proposed are clear and appropriate. However, the proposal should also require allowable oversight and review by the PCAOB or similar international body that provides assurance to the auditor that uniform professional oversight supports the audit process. As presented, the auditor is being asked to provide efforts that cover both audit process and oversight process.

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

The modifications in AS 1206 are clear and appropriate.

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?

The proposed amendments to AS 1105.B1 appear clear and appropriate.

We appreciate the opportunity to provide input into the standards-setting process.

Sincerely,



Lyle C. Joiner, CPA
Chair, Professional Standards Committee
Texas Society of Certified Public Accountants

NOTICE: This is an unofficial transcript of the portion of the Public Company Accounting Oversight Board's Standing Advisory Group meeting on May 18-19, 2016 that relates to *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard—Dividing Responsibility for the Audit with Another Accounting Firm*. The other topics discussed during the May 18-19, 2016 meeting are not included in this transcript excerpt. The Public Company Accounting Oversight Board does not certify the accuracy of this unofficial transcript, which may contain typographical or other errors or omissions. An archive of the webcast of the entire meeting can be found on the Public Company Accounting Oversight Board's website at: <https://pcaobus.org/News/Events/Pages/SAG-meeting-May-2016.aspx>.

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

+ + + + +

STANDING ADVISORY GROUP

+ + + + +

MEETING

+ + + + +

THURSDAY
MAY 19, 2016

+ + + + +

The Advisory Group met at the Washington Plaza Hotel, 10 Thomas Circle, Northwest, Washington, D.C., at 8:30 a.m., James R. Doty, Chairman, presiding.

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1 their work than the lead auditor who had final
2 responsibility for the audit.

3 On April 12th, the Board issued this proposal to
4 strengthen the requirements for lead auditors and provide
5 a more uniform approach to supervision in audits that
6 involve other auditors. It amends existing requirements
7 pertaining to supervision, planning, documentation as
8 well as the not concurring partner but engagement quality
9 review with respect to other auditors.

10 There are also a relatively few instances where the
11 lead auditor doesn't have the ability to get into review
12 or see the work of those other auditors. If that's the
13 case, we don't think that the lead auditor should
14 nonetheless take responsibility for the entire audit if
15 they can't have access to the work done by the other
16 auditor.

17 That happens most frequently in the situations we
18 see where there might be an equity investment that's
19 significant and Management doesn't have the ability to get
20 their own audit of the top company to get their lead auditor
21 into that equity investee and they have a different auditor
22 in that company.

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1 This proposal includes a new standard for
2 circumstances in which the lead auditor divides
3 responsibility with another firm. That was permitted
4 under existing standards. This new standard increases
5 somewhat the responsibilities of the lead auditor in
6 determining the qualifications of that other auditor when
7 they divide responsibility. That other auditor has to be
8 mentioned in the audit report including the scope of work
9 and the amount of work that they performed. The comment
10 period on this ends on July 29, 2016.

11 Again, as I mentioned, some of the key changes, this
12 applies a single approach for supervision. There were a
13 couple of standards that could be applied in this world
14 of supervising other auditors. So this is a single
15 approach for the supervision of the work of all other
16 auditors when the lead auditor assumes responsibility for
17 that work. As I mentioned, this is linked in and tied into
18 our risk assessment standards.

19 It includes more specific requirements for the lead
20 auditor's supervision of other auditors to prompt the
21 other auditors to be more involved in the work of those
22 other auditors especially in the areas of greatest risk

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1 of material misstatement. Really, our incentive here is
2 that the lead auditor be very actively involved in and is
3 required to be actively involved in determining the scope
4 of work that the other auditors do, setting a tolerable
5 misstatement for the other auditors, determining what type
6 of opinion that they want from the other auditors or what
7 type of report or work papers they want sent back and
8 determine that all of that was done and conclude that the
9 other auditor performed the work in accordance with those
10 instructions.

11 It also includes a requirement that whenever other
12 auditors work on the audit determine that the firm issuing
13 the audit report sufficiently participates in the audit
14 to serve as the lead auditor. Again, we have seen some
15 instances where -- and I mentioned a case before -- maybe
16 the lead auditor did maybe a handful of the work and 90
17 percent of the work was done in some other market by some
18 other auditor.

19 Hopefully, this new standard would not permit that
20 to happen as the lead auditor has to audit a significant
21 portion of the risks of material misstatement with respect
22 to that any particular audit. And guidance and rules are

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1 given with respect to the determination as to whether or
2 not your participation is sufficient for you to serve as
3 the lead auditor.

4 The proposed standard also strengthens existing
5 standards by providing more specific requirements
6 regarding the lead auditor's responsibility to gain an
7 understanding of the qualifications of the other auditors
8 at the outset of the audit including an understanding as
9 to whether or not they'll be able to gain access to the
10 work papers of those other auditors. But it's really
11 geared to make sure that the lead auditor knows who is the
12 engagement partner on the many different subsidiaries
13 around the world and the other lead people who are
14 responsible for supervision and are those the right
15 people. Do they have the right capabilities for this
16 particular industry and for this particular audit to
17 support that work and to do high quality auditing to
18 support the role of the lead auditor?

19 You have to gain that understanding about the
20 qualifications at the outset of the audit in order to set
21 the proper scope of work to be performed and to set the
22 proper capability for you to have the right work to review.

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1 As I said, this proposal will be reviewed and discussed
2 in more detail tomorrow.

3 ...

4 MS. MOONEY: On the other auditors when I'm
5 thinking about China and some other Asian jurisdictions,
6 I'm curious. Is there deference? I'm trying to figure
7 out how the supervision works for like the
8 multi-nationals? Will there be deference to the local
9 laws in some areas? Would the auditors need to get visas
10 to get -- I mean how will they be able to step up supervision
11 where there are restrictions like that?

12 MR. BAUMANN: The lead auditor has to fulfill the
13 planning and supervisory responsibilities of the audit
14 with respect to all other auditors wherever they're
15 located and there's no distinction drawn. If the lead
16 auditor is unable to get satisfactory access to the work
17 done, unable to review work papers that the lead auditor
18 thinks he or she needs to review, that would be a scope
19 limitation.

20 MS. MOONEY: Thank you.

21 MR. BAUMANN: So there's no deference given to the
22 fact that you can do less work and serve as a lead auditor

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1 if some of the work's done in some other market.

2 Philip, did you have a follow-up on that?

3 MR. JOHNSON: That's where I have an issue with
4 having the proposed new standard allowing other auditors
5 to be named in the audit opinion. I think it's basically
6 having two opinions.

7 From my perspective, the lead auditor is providing
8 assurance over the financial statements as a whole. I
9 guess there is an equity investor. And you can't get
10 access to the work papers of the auditor as you described.
11 Then I think that's a scope limitation and should be said
12 rather than having the standard.

13 From my perspective I think that it should be one
14 opinion and I'm picking on what was said there. And I was
15 going to raise that point and then raise it again next time.
16 But I think because of this exchange I think it is important
17 that we don't treat matters in a different way just because
18 you can't get access into China. It's no different than
19 having access to another U.S. firm, for example, on a
20 particular aspect of that balance sheet.

21 MR. BAUMANN: This is getting back to the divided
22 responsibility scenario and sort of backing off the

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1 auditor reporting model. But these questions, that's
2 alright. We'll take them. They're important.

3 We're interested in comments on the proposal. But
4 I guess there are two alternatives and one is let's just
5 say -- And I don't think this is an issue with respect to
6 China really. Typically auditors are able to get access
7 to that audit work and to review the work there.

8 This is typically more of a situation where there's
9 a separate ownership issue -- let's say an equity investee
10 or something -- where the corporation has an equity
11 investee that's material to the financial statements.
12 But they have their own auditor. And the lead auditor just
13 can't get into that company to review that work.

14 Rather than having a scope limitation, this
15 provides the possibility for that other auditor to do an
16 audit in accordance with PCAOB standards of that separate
17 entity and for it to be disclosed in the audit report that
18 with respect to a certain amount of the assets or a certain
19 amount of the revenue or income that the auditor report
20 relies entirely on that other audit of that portion of the
21 audit.

22 And that auditor is named in that report. That

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1 financial statements and that audit report are filed with
2 Securities and Exchange Commission and are available for
3 investors to see.

4 Again, interested to see and have comments on that
5 if some think that's not right. I do know the IAASB
6 standard, the analogous standard for group audits, does
7 not permit divided responsibility; whereas the U.S. does.

8 Liz, did you have a question on this same issue?

9 MS. MURRALL: You actually have just answered my
10 question because it was about the fact that other
11 international standards do not have this divided
12 responsibility and just how they address it. I think from
13 an institution investor perspective we firmly believe that
14 the group auditor should take responsibility for the audit
15 as a whole as Philip has articulated.

16 MR. BAUMANN: We do, too. And we hoped that would
17 be the case. I said this is relatively few cases, but if
18 the lead auditor cannot for whatever reasons then the
19 question arises is it better to have a scope limitation
20 and not have an unqualified opinion. Or is it better to
21 have the ability to have another auditor do an audit in
22 accordance with PCAOB standards which means we'd have the

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1 ability -- which gives transparency to that work to the
2 investor.

3 But again, we have that out for comment. And we'll
4 be interested in views on that.

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May 19, 2016

MR. BAUMANN: We'll be beginning this final session shortly.

So our final session is an important one, as everything on the agenda has been important to us and hopefully to you.

We did issue just recently a proposal in a very important area, and that deals with the lead auditors' involvement in planning, supervision, review, et cetera, of the work of other auditors. As you know, in most multinational engagements there can be very significant portions of the work done in many places around the world and that can add up to a very significant piece of the revenue and assets and income of the company. And the work, therefore, of other auditors is critical to the success of the audit. And so, this proposal dealing with the lead auditors' involvement and supervision of that work is key to investor protection and audit quality.

Joining me for this presentation are Keith Wilson, Dima Andriyenko and Lillian Ceynowa.

And I think I'm turning it over to you first, Dima?

MR. ANDRIYENKO: Yes.

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1 MR. BAUMANN: Okay.

2 MR. ANDRIYENKO: Thank you, Marty.

3 First, Lillian and I would like to provide a
4 high-level overview of the proposal and after our
5 introduction we're going to pose several discussion
6 questions on the screen.

7 The proposal that the Board issued on April 12
8 focuses on a large segment of audits conducted by firms
9 registered with the Board. These are audits that involve
10 not only the firm that issues the audit report on the
11 company's financial statements, what the proposal calls
12 the lead auditor, but also other firms and accountants
13 outside the lead auditor firm, what the proposal calls
14 other auditors.

15 Other auditors can be accounting firms outside of
16 the lead auditor's global network, but in many instances
17 they are firms from the same network as the lead auditor.
18 For example, if the lead auditor is headquartered in the
19 U.S. and audits a U.S. company that has operations in the
20 U.K. and the U.S. firm uses its U.K. affiliate to audit
21 the company's U.K. operations, the affiliate firm would
22 be considered the other auditor for purposes of the

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1 proposal.

2 The Board's proposal would strengthen the existing
3 standards that govern audits involving other auditors.
4 Today in some situations the lead auditor can assume
5 responsibility for the other auditor's work after
6 performing specified procedures that are not explicitly
7 required to be tailored for the associated risks. The
8 proposal would strengthen existing requirements with
9 respect to supervision of the lead auditor -- by the lead
10 auditor of the other auditors, but also with respect to
11 the planning, documentation and the engagement quarterly
12 review involving other auditors.

13 Overall the proposed changes are designed to
14 increase the lead auditor's involvement in the work
15 performed by other auditors and also in the evaluation of
16 that work. For example, the proposal includes specific
17 requirements for the lead auditor's review of the work
18 performed by other auditors.

19 The purpose of the greater involvement by the lead
20 auditor is to enhance the auditor's ability to prevent or
21 detect deficiencies in the work of other auditors. PCAOB
22 inspectors observe deficiencies in the other auditors'

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1 work that the lead auditors either did not identify or did
2 not address.

3 The Board also proposed a new standard for
4 situations in which the lead auditor divides the
5 responsibility for the audit with another accounting firm.
6 In these audits the lead auditor refers to the other firm
7 in the lead auditor's report. And we will discuss these
8 situations in a little bit more detail later in the
9 presentation.

10 In addition to the discussion questions that you
11 will see in our slides, there are 59 questions in the
12 proposing release and in Appendix 4 to the release. The
13 Board is seeking comments on all aspects of the proposal,
14 including costs and benefits of the proposal and
15 alternatives to the proposal. We're very interested in
16 any empirical data that you can provide that would support
17 your views on the proposal. And the Board is also seeking
18 specific comments on the proposed amendments to existing
19 PCAOB standards and on the proposed new standard.

20 Now I'm going to turn this over to Lillian and she
21 will provide you with an overview of key changes to the
22 proposal. And then we'll put on the screen our discussion

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1 questions.

2 MS. CEYNOWA: Thank you, Dima.

3 Now that Dima has provided you with some background
4 a high-level overview of what the Board's proposal is
5 intended to do, let me now highlight for you some key
6 changes. I will start with supervision of audit
7 engagement.

8 The proposed amendments to the standards do two
9 things: First, the proposed amendments are designed to
10 align the applicable requirements with the PCAOB's
11 risk-based supervisory standards. The Board's proposal
12 will supersede AS 1205, which is currently called AU 543,
13 and establish a uniform risk-based supervision approach.
14 This would result in requiring that in all audits in which
15 the lead auditor assumes responsibility for the work of
16 another auditor the lead auditor would supervise the other
17 auditor's work in accordance with the PCAOB's risk-based
18 supervision auditing standard.

19 The Board's existing supervision standard and
20 standards for determining the scope of multi-location
21 audit engagements requires more audit attention to areas
22 of greater risk. The existing standard on using the work

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1 of other auditors, however, allows the lead auditor in
2 certain situations to limit its involvement to certain
3 specified procedures that are not explicitly required to
4 be tailored for the associated risks.

5 Applying a risk-based approach would direct the
6 lead auditor's supervisory responsibilities to the areas
7 of greatest risk. This should result in the lead auditor
8 focusing on the riskiest areas of the audit, whether those
9 areas are audited by the lead auditor directly or by
10 another auditor under the lead auditor's supervision.
11 The proposed supervision approach would apply to all
12 auditors, which would include both affiliated accounting
13 firms as well as non-affiliated accounting firms.

14 The second area of change the Board is proposing
15 in the supervision standard is that it would provide
16 additional direction to the lead auditor on how to apply
17 the principle-based provisions of the Board's existing
18 supervision standard. Additional direction could help
19 the lead auditor assure that its participation in the audit
20 is sufficient for it to carry out its responsibilities and
21 issue an audit report based on sufficient appropriate
22 audit evidence.

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1 The proposed additional direction would required
2 the lead auditor to do the following things: To inform
3 the other auditor in writing of the scope of work,
4 tolerable misstatement and the identified risks of
5 material misstatement; to obtain and review the other
6 auditor's description of the nature, timing and extent of
7 audit procedures to be performed including communicating
8 in writing any changes to the proposed procedures that are
9 necessary; to direct the other auditor to provide for
10 review specified documentation; to obtain from the other
11 auditor a written report describing the other auditor's
12 procedures, findings, conclusions, and, if applicable,
13 opinion; and to determine whether the other auditor
14 complied with the lead auditor's written communications
15 and whether additional audit evidence would be obtained.

16 Consistent with existing standards the extent of
17 the lead auditor's supervision and review would be
18 determined based on requirements of the standard on
19 supervision. For example, the higher the likelihood of
20 the risk of material misstatement associated with the
21 areas in which other auditors perform audit procedures,
22 the greater should be the extent of the lead auditor's

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1 supervision of the other auditor's work.

2 Now let me turn to two other areas which reside
3 currently in the amendments to the planning standard. Let
4 me highlight two areas: One is sufficiency of
5 participation and the other one is qualifications.

6 The first area involves the principle that the lead
7 auditor, the auditor signing the audit opinion on the
8 consolidated financial statements, performs audit
9 procedures on a significant or meaningful portion of the
10 financial statements. Currently for audits involving
11 other auditors that are governed by the existing standard
12 AS 1205, the standard we are proposing to supersede, the
13 auditor is required to determine whether its participation
14 is sufficient for it to serve as principle auditor in order
15 to issue an audit report on the consolidated financial
16 statements.

17 The Board's proposal would extend the requirement
18 for determining the sufficiency of its participation to
19 all audits that involve other auditors, not just those that
20 are currently covered under the existing standard. This
21 would even apply in situations in which the auditor divides
22 responsibility with another accounting firm. This change

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1 is designed to increase the likelihood that the firm
2 issuing the auditor's report performs procedures for a
3 meaningful portion of the company's financial statements.

4 The proposed requirement would do two things:
5 First, it would impose the determination of the
6 requirements specifically on the engagement partner and
7 it would require that the engagement partner determine its
8 sufficiency of participation based on the following
9 things:

10 It would be based on the risks of material
11 misstatement associated with the portion, including the
12 portions materiality of the company's financial
13 statements, audited by the engagement partner's firm in
14 comparison with portions for which the other auditors
15 perform audit procedures. The proposed risk-based
16 criterion is intended to capture both quantitative and
17 qualitative characteristics of a particular scenario.
18 Under this criterion the lead auditor ordinarily would
19 need to audit the location at which the primary financial
20 statement decisions were made and consolidated financial
21 statements were prepared.

22 The second item I'd like to talk about is

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1 qualifications of the other auditor. The Board's
2 proposal builds on and strengthens the existing standards
3 by requiring that when planning the audit the lead auditor
4 gain an understanding of the qualifications of the other
5 auditors who will assist the lead auditor with planning
6 and supervision, including gaining an understanding of
7 their experience in the industry in which the company
8 operates, knowledge of the relevant financial reporting
9 framework, knowledge of PCAOB standards and SEC rules and
10 regulations.

11 Gaining an understanding of the knowledge, skill
12 and ability of the other auditors' supervisory personnel
13 is necessary for determining the extent of the lead
14 auditor's supervision of the other auditors. A lack of
15 the appropriate qualifications by the other auditors who
16 assist the lead auditor with planning and supervision
17 could have an adverse effect on the effectiveness of
18 supervision and may increase the likelihood that auditors
19 would not identify material misstatements in the company's
20 financial statements.

21 The proposed requirements seek to apply a balanced
22 and practical approach by focusing the lead auditor's

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1 attention on the qualifications of the more senior
2 engagement team members of the other auditor; that is,
3 those who assist the lead auditor with planning or
4 supervision.

5 The proposal would also require that the lead
6 auditor during the planning stages of the audit to
7 determine that the lead auditor is able to communicate with
8 the other auditor and is also able to gain access to the
9 work papers.

10 These proposed amendments of the audit planning
11 standard are designed to alert the lead auditor at the
12 outset of the audit to difficulties they may encounter in
13 obtaining and evaluating audit evidence collected by the
14 other auditors so that the lead auditor may take
15 appropriate action.

16 MR. ANDRIYENKO: Okay. On the screen now there's
17 a slide with the first of our discussion questions for
18 today. And to tee it up we also included a bit of
19 background information.

20 The use of other auditors is prevalent today. It
21 is specialists among larger companies audited by larger
22 accounting firms. For example, other auditors are used

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1 in over half of audits performed by U.S. global network
2 firms and about a third of audits performed by non-U.S.
3 global network affiliate firms.

4 By another measure, approximately 80 percent of the
5 Fortune 500 each year audits performed by U.S. global
6 network firms involved other auditors. Other auditors
7 can perform audit procedures in critical audit areas and
8 PCAOB inspections continue to identify deficiencies in the
9 other auditors' work that the lead auditor did not identify
10 or did not address.

11 So the question is about your views on the need for
12 increased involvement by the lead auditor in the work of
13 other auditors and in the oversight of the other auditors'
14 work.

15 MR. WILSON: Thanks, Dima.

16 So we're going to open up for questions or comments
17 that anyone might have on thoughts on this topic. Do you
18 in fact think it is important for the lead auditor to have
19 involvement and oversight of the work?

20 So we'll begin with Bob Herz.

21 MR. HERZ: Well, thank you. I'm generally
22 supportive of the objectives of this proposal. I guess

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1 it's more of a question, just thinking back to work I did
2 at PwC in terms of global quality and work that I did as
3 the head of the Transnational Auditors Committee if IFAC,
4 of to what extent would the lead auditor be encouraged or
5 permitted to take into account in the evaluation the firm's
6 internal quality control procedures over that other audit
7 affiliated firm, that other auditor?

8 So if say one of the major parts of the operation
9 of the company being audited were in U.K. and the firm has
10 done a lot of internal controls, internal quality work on
11 the U.K. firm does it and how that can be kind of taken
12 into account and used efficiently and effectively in this
13 process.

14 MR. WILSON: Thanks. So one reaction to that, I
15 think we do want to get comments in that area. I think
16 it's important for --

17 the proposal tries to talk about the information that the
18 lead auditor needs to have in evaluating those
19 qualifications. And certainly information could be
20 available to the lead auditor from that perspective.

21 So we would be interested in comments, people's
22 views and experiences on the extent to which that works

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1 today in practice and how well that works and how much
2 information the auditor actually gets as compared to --
3 and I'm not suggesting that any of the situations you were
4 describing are this way, but as opposed to sort of a blind
5 reliance kind of approach of there is -- we know they have
6 a quality control system. We don't know much about it.
7 We don't know much about the particulars. So I think
8 that's an area that we're very interested in.

9 Phil Santarelli?

10 MR. SANTARELLI: Thank you. In response to the
11 question I'm very supportive of the Board taking up this
12 project. I think frankly AU 543 needs modernization.
13 It's a very old standard. The world has changed a lot.

14 I think as noted in the release many firms have
15 attempted to modernize their procedures with respect to
16 these group audits using ISA 600, which has moved that
17 continuum quite a bit. But I don't think that's
18 necessarily universal. And I think you still have
19 situations where many firms doing a group audit in an
20 international setting may be their only group audit and
21 they're relying on AU 543. And I currently don't believe
22 it's efficient.

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1 So this modernization I think is needed to improve audit
2 quality, and we're supportive of it.

3 MR. WILSON: Thank you. Rick Murray? MR.

4 MURRAY: The challenge of transnational auditing, the
5 challenge of fitting the audit process and the concomitant
6 regulatory challenges of the globalization of commerce is
7 a major one, and I commend the attention that it's getting
8 here.

9 It's been a major issue for at least 40 years and
10 it has been a matter that the profession has been working
11 away at pretty diligently through that time. The
12 conditions that existed at national boundaries in the '70s
13 and '80s would look pretty crude to anyone examining
14 practice today. I mention that only to suggest that this
15 is neither new nor unaddressed, but I welcome the attention
16 to how can it be improved.

17 The concerns that I have or the questions I would
18 put to you are basically twofold: Given the fact that this
19 has been around pretty much forever in terms of global
20 commerce, and it will be, I don't think anyone can assume
21 that whatever action the Board takes in a standard setting
22 now is going to fix the future and be able to say, well,

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1 done with that. Now everything's under control.

2 So I think the idea that seems assumed in this
3 proposal suggests that if the lead audit partner is made
4 to understand that it is his or her responsibility and
5 given the tools and the risk-based demand that they meet
6 that responsibility, that the problem will go away. It
7 won't. It is one that the business community, the capital
8 markets, the audit profession and the regulatory world
9 will continue to struggle with.

10 So I'm troubled by the sense that this is a solution
11 and troubled by the implication that in taking action at
12 the PCAOB Board level to mandate that the audit partner
13 not only has the responsibilities, which is fine; I don't
14 disagree with that, but has the responsibility also to
15 self-determine that he or she has met those
16 responsibilities is a form of passing the regulatory
17 burden back to the audit profession. And I don't think
18 that's a realistic expectation. MR. BAUMANN: Well, I'd
19 like to maybe just explore that a little bit further. And
20 I don't think that any standard is a complete solution to
21 any particular problem, but it's trying to strike the right
22 balance, of course, whenever we have any new proposal or

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1 new standard.

2 But I think it is the responsibility of the audit
3 firm signing the opinion as opposed to maybe a regulatory
4 burden, I think is what you indicated, to ensure that they
5 have obtained sufficient appropriate evidence, the lead
6 audit firm - the lead audit partner - to sign that opinion.
7 And so, what we're trying to get at here is would the
8 increased involvement and oversight by the lead audit firm
9 on the work of that other auditors contribute to improved
10 audit quality, reduce deficiencies or identification of
11 the deficiencies in the work of the others to improve audit
12 quality and protect investors more?

13 So it is a problem that's been around for awhile.
14 I think Phil made a very good point that existing Standard
15 AU 543 hasn't changed necessarily with the times. Many
16 of the firms did enhance their models around ISA 600 when
17 that came out, but even Arnold's pointed out that that's
18 another area that they're continuing to look at because
19 as many times as they exposed Group Audit Standard ISA 600,
20 still with experience it shows there are challenges.
21 There are unique incentives between what the lead auditor
22 has to do and the incentives that the other auditor might

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1 have in their work at a subsidiary location.

2 And so, this is trying to get views from commenters
3 about enhancing or increasing the responsibility of the
4 lead auditor to gain an understanding of the
5 qualifications, who the people are performing the work at
6 those other locations. Are they the right people? And
7 then therefore, are the instructions sufficient enough
8 given to those other auditors so they understand them and
9 then perform those procedures and get the right report back
10 to the lead auditor so they can evaluate the work.

11 So I understand your point that nothing is going
12 to solve this and we don't expect zero deficiencies at the
13 end of the day, but hopefully we reduce the extent of the
14 problems we see today in the work done by other auditors.
15 So I accept the general concern you have and hopefully this
16 is principles-based enough to live a long time. And your
17 point is things will change and evolve again over time.
18 In this standard we tried to make this principles-based
19 that would live for time, but we'll look for comments to
20 see if people think that -- if that's the case.

21 MR. MURRAY: Thanks, Marty. And I agree with
22 virtually everything you said. I agree with everything

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1 you said. What's not quite addressed is why is it then
2 necessary to say that the lead audit partner must
3 self-declare that they've done it and fixed it? They've
4 done everything they need to do to make sure that
5 transnational financial reporting is going to work as
6 intended? Well, it's not. And it's that last step of
7 imposing an unachievable responsibility on a role that
8 cannot have the tools to avoid deficiencies in the future.
9 That's the step that I'm concerned about.

10 MR. BAUMANN: Great. We'll look for others'
11 comments on what the expectation should be of that lead
12 auditor. Thanks, Rick.

13 Bob Hirth?

14 MR. HIRTH: Thanks. I support this overarching
15 concept of the lead auditor and coordinating that and the
16 lead auditor versus the firm taking responsibility. So
17 like Phil said, I think it should be modernized, and it
18 is. So I support all that.

19 Some of this is all convoluted because of the firm
20 structures. I'll explain that in a second.

21 Also, I think your comments about the reverse
22 mergers and the reverse lead auditor, auditors did all the

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1 work issues on the China reverse mergers. Absolutely.
2 And if this helps address that and improves that,
3 wonderful. Good. That's really good. I'd ask how much
4 of this is being driven by that.

5 But just so everybody understands; and David and
6 others will correct me, because I don't know if everyone
7 understands what other auditors are -- so we have an audit
8 in the United States and we use 16 different offices and
9 they're all Accounting Firm, LLP. Same one. Pick the
10 four or six firms. There are no other auditors involved
11 in that audit, right? It's the one U.S., LLP.

12 Correct, Marty?

13 MR. BAUMANN: Say that again.

14 MR. HIRTH: So we have audit U.S. operations only,
15 but I use eight or 10 offices of my firm in the U.S. No
16 other auditors.

17 MR. BAUMANN: That's correct.

18 MR. HIRTH: Correct.

19 MR. BAUMANN: That's the same firm.

20 MR. HIRTH: Now I have an audit and I use my office,
21 as Bob says, in the U.K. And we have the same name. We
22 are not the same firm. And he's another auditor, correct?

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1 I just want to make sure everybody understands that.
2 Okay?

3 Then let's go one step further: We use the same
4 name. There are some firms that don't use the same names,
5 but have a network and might have an international client.
6 And I'm called Bob Hirth, LLP in the U.S. and I just Jim
7 Doty, LLP in another country. We're part of the same
8 network, we're calling the Marty Bauman network. He's
9 another auditor, right? So I want to make sure you kind
10 of understand that.

11 So Bob and I are using the same firm's name, but
12 he's the other auditor. Just want to make sure everybody
13 sort of understands all that. And I think there are
14 some -- so I think the overarching goal here is the same,
15 but there's all these different permutations of same firm
16 in one country. That's one LLP. Firms that use the same
17 name and now they're other auditors. There's looser
18 affiliations. And then there's this revision you're
19 going to make to -- I'm called --

20 CHAIRMAN DOTY: You're in real trouble if you're
21 relying on me for audit --

22 (Laughter.)

1 MR. HIRTH: But and then there's this issue of
2 using a totally different firm and looking at reliance.
3 So I want to make sure everybody kind of understands that.
4 So I support that.

5 And then I guess I'd be interested in what the other
6 firms think. And then also what the non-U.S. participants
7 here think about this as well.

8 MR. WILSON: So just for clarification, in your
9 example; I just want to be sure that we've let everyone
10 on the same page here, you're right, everyone is -- in all
11 those examples you're talking about multiple firms.
12 Maybe they share the same name. Only the lead auditor
13 issues the report. It's not the network that issues the
14 report. Only the lead auditor issues the report. So I
15 think that's an important factor in the way that we think
16 about it. And you're right, it helps drive some of the
17 thinking on the proposal.

18 So you ask about responses from firms. So, David
19 Kane, your name was on the list; not to put you on the spot,
20 but you were next in line.

21 MR. KANE: Sure. Well, I think just I agree with
22 what Bob said in terms of the legal structure. And I think

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1 this effort and the Board and the staff should be
2 commended, because I think this is an important topic to
3 improve audit quality more globally.

4 I think Form AP is going to help when you start
5 putting these together, because starting next June for
6 reports we issue -- are issued or reissued after next June,
7 according to the five percent, investors will have that
8 transparency and will be able to understand exactly same
9 firm name, different firm name, level of participation and
10 have the power and the benefit of that information there.

11 I mean, my overall sense is; and I think this rule
12 proposal captures it, that I think some of the larger firms
13 have been already incorporating a lot more review and
14 supervision over the last several years. I think it's
15 never been greater than it is today. You see much more
16 having people from the primary team actually go over to
17 the local countries and the component teams to sit down
18 with them, particularly in some more challenging areas,
19 let's say, like in terms of ICFR. So I think the days of
20 just grabbing summary packages and just limiting it to
21 what's in AU 543 strictly are in the past. I don't think
22 that's current practice today.

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1 And I think one question I did have was though, just
2 on the AU 543, how much the Board meant to tighten the
3 sufficiency of work and the determination of lead auditor.
4 Here's the reason I ask that question on that: Is another
5 consideration here is state law. So in many states for
6 companies that are headquartered in that state they have
7 to be audited by a firm that is licensed and registered
8 to practice public accounting in that state, which in many
9 cases requires U.S. CPAs, to majority own that firm.

10 So you could end up in a situation, depending upon
11 how much the AU 543 current criteria we're going to be
12 restricted a bit more, that the lead auditor might actually
13 be a foreign firm that would not be licensed to practice
14 in that state and potentially issue that report. So there
15 might be some companies that are left a little bit in no
16 man's land. So I just think the state/local laws around
17 the world are going to be another consideration here when
18 also just thinking about determining who the lead auditor
19 is.

20 MR. WILSON: Thanks. That's a really good point.
21 I think that's an area that we are interested in
22 understanding some of the issues that people may run into

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1 in that space.

2 I think the main thing was I think it was felt to
3 be important that the lead auditor not -- to have -- do
4 a meaningful portion of the audit work themselves, that in
5 order to be able to credibly be able to sign the report.
6 I think the question then becomes what's the criteria one
7 uses for that, as you alluded to. And what the proposal
8 does was apply the criteria essentially that are used in
9 determining the scope for multi-location engagement,
10 which is driven by risk.

11 So we're interested in whether that risk frame
12 helps, whether that seems to have -- whether people are
13 finding that that causes some kinds of issues that may come
14 up in practice or how that plays out. But we thought that
15 was a more meaningful and realistic approach than simply
16 the approaches that sort of have one criteria for
17 sufficiency and participation, the old AU 543, and a
18 different criteria for scoping the audit. So we're trying
19 to bring those in line and thought we'd get to the --
20 roughly the same place.

21 MR. KANE: Yes, so I think there are some
22 opportunities we have in the comment letter to give you

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1 some fact patterns and some things to think about.

2 Another one just on that thought on risk of material
3 misstatement was did you consider or is one required to
4 consider the financial reporting determination and where
5 that is? So, one of the things that's in there is that
6 wherever the financial reporting decisions are made,
7 typically you think about that. Is that a requirement?
8 Because sometimes you could have situations where the
9 risks of material misstatement are completely different
10 than where the financial reporting decisions are made.

11 MR. WILSON: Right. So the proposal itself hinges
12 on the risk of material misstatement, so however that might
13 be. I think what the proposal also tries to point out is
14 that there are situations in which there are some unique
15 risks around the financial statements that otherwise might
16 not be addressed. So we're thinking about whether or not
17 there are situations where someone may operate say a very
18 large operating subsidiary, but not have any visibility
19 into the financial statements and questions about then how
20 would that auditor be able to reach an opinion and sign
21 a report?

22 So those are some of the thoughts, but we're very

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1 interested in comments in this area.

2 MR. KANE: Yes, and just one last observation here;
3 and Bob Herz touched on this, but I think it's an important
4 one that's more take-away for us in thinking about in terms
5 of a firm's reliance on, or a partner's reliance on system
6 of quality control versus what they specifically need to
7 do.

8 I think the principles that are outlined in here
9 make a lot of sense. It's just more of how does the primary
10 team document and execute and evidence some of that? So
11 when you start thinking about ethical requirements or
12 independence can reliance on global code of conduct or
13 independence monitoring, if you have a global system, can
14 that satisfy? So it's just some take-aways for us to think
15 about as well in terms of how to strike that right balance
16 to make sure that the evidence is there and it's meaningful
17 without a check-the-box.

18 MR. WILSON: Right. No, those would be -- those
19 are helpful comments for us, hopeful thoughts.

20 MR. BAUMANN: I just wanted to get into the
21 dialogue a little bit. This is a really important point
22 in the release; and we are seeking comment on this,

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1 sufficiency of participation by the lead auditor in the
2 audit. Some cases are probably pretty black and white
3 where 90 percent of the work is done in the U.S. and there's
4 a subsidiary somewhere that represents 10 percent of the
5 assets and revenue. And it's probably pretty obvious with
6 all the key decisions made in the U.S. and most of the
7 assets and revenue that the lead auditor's participation
8 is sufficient.

9 Some others are probably pretty black and white
10 when -- Bob I think talked about, Bob Hirth, the reverse
11 mergers where 98 percent, or some very high percentage of
12 the revenue and assets are in some other country and there
13 was a reverse merger, and some U.S. firm was signing the
14 report that was formerly a shell company. And now they,
15 via the reverse merger, are a registrant with such a great
16 portion of that work being done by some overseas firm with
17 maybe today under 543 very limited involvement by the lead
18 auditor. Maybe that's a black and white situation that
19 they're just not doing enough work to really sign that
20 report. That might be black and white.

21 And then you have the situation with a very
22 diversified company that's got 10 percent of its assets

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1 in revenues in the U.S. and 10 percent in nine other
2 countries around the world, and each of those 10 operations
3 in different countries are all important. And then
4 assessing the lead auditor's responsibility. There a key
5 element is probably the degree to which they exercise the
6 responsibilities of this standard, they were sufficiently
7 involved in the risks of material misstatement in those
8 other entities and they're probably auditing the lead
9 consolidation where key financial reporting decisions and
10 disclosures are made.

11 So there's an infinite, maybe, number of situations
12 to be considered in this sufficiency decision and
13 information you all can provide us as to what are some of
14 the challenges of implementing this, yet coming up with
15 the right goal of saying the lead auditor needs to have
16 sufficient participation to actually sign the accounts is
17 important. So information, other empirical evidence,
18 various types of situations and evaluating those would be
19 very helpful in the response to the questions we ask in
20 the release.

21 MR. WILSON: Liz Murrall, I think you had your card
22 up earlier and put it down. Did you have a comment?

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1 MS. MURRALL: Well, just very much welcome the
2 improvements that are being made for the supervision of
3 auditors and how this will improve audit quality.

4 MR. BAUMANN: If you'd move the mic a little bit,
5 Liz?

6 MS. MURRALL: Oh, sorry. Is it not on?

7 MR. BAUMANN: Oh, just a little closer. Thank
8 you.

9 MS. MURRALL: Okay. Sorry. Thank you.

10 Investors firmly believe that lead audit partners
11 should take responsibility for the audit and stand behind
12 the judgments, et cetera, that are made. One of the
13 concerns that I've had that has raised quite recently is
14 that we're aware as investors that each of the firms and
15 each firm in a network will have quality control
16 procedures.

17 The IAASB has recently been consulting on audit
18 quality, and in that it's looked at professional
19 skepticism, quality control and group audits. And I
20 suppose I was somewhat concerned that the quality control
21 procedures were not reviewed at the network level,
22 particularly given the international nature of audit and

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1 the international nature of the audit firms, that this is
2 not actually addressed in the standards. And whether or
3 not, and if that cannot be done because of the differing
4 structures of the networks, can it not be done at least
5 at the engagement level?

6 MR. WILSON: Thanks. And that is something that
7 we're going to be thinking about in terms of how the
8 proposal -- how the issues like what were teed up earlier
9 about how the auditor uses that, the lead auditor uses that
10 information in the engagement level. It's also something
11 that we'll be thinking about in our larger quality control
12 project and how the -- what the right kinds of quality
13 controls ought to be in those situations where there are
14 network arrangements.

15 So, Brandon Rees?

16 MR. REES: Thank you. I wanted to also add my
17 voice from an investor perspective in favor of enhanced
18 oversight of other auditors by the lead auditor.

19 I think there's an investor expectation gap about
20 what is expected for the supervision. I was looking at
21 a U.S.-based multinational consumer products company just
22 this week that had 80 percent of its revenue outside the

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1 United States and all its expected future growth is going
2 to be from outside the United States. And so, what does
3 it really mean when the lead firm is signing the -- what
4 do I think that means as an investor when the lead firm
5 is signing it? I do believe that the transparency of
6 other audit participants will help align investor
7 expectations with the reality, but I don't want investor
8 expectation to be lowered. This is the kind of rulemaking
9 area that I think as an investor I say, well, isn't this
10 what firms are already doing, and shouldn't they be doing?
11 And it's sort of like one of those sort of hair raising
12 moments where you think, well, maybe this isn't always
13 being done and therefore it's helpful to have a uniform
14 standard to be applied.

15 MR. BAUMANN: I think this was mentioned before.
16 There's been enhancements beyond what maybe the existing
17 standards are. But I think practice varies, so I mean,
18 this standard is intended to get a uniform high degree of
19 oversight and supervision in all cases and not just in some
20 cases. So I agree with your point, it would be hair
21 raising if this isn't done, but it's not done in all cases.

22 MR. WILSON: Phil Santarelli?

1 MR. SANTARELLI: Yes, this is probably either a
2 naïve or a dumb question, but this concept of sufficiency
3 which has in the standard a quantitative and qualitative
4 element to it, which I agree with -- but my recollection
5 is that there's still -- in the Corporation Financial
6 Reporting Manual they actually address when acting as a
7 principal auditor, all term, AU 543 term principal
8 auditor, that in their view, staff's view is that the
9 principal auditor needs to cover more than 50 percent of
10 the balance sheet or income statement, which is obviously
11 very quantitative. Is there a little disconnect there?
12 I'm sure practice has evolved, but it's still in that FRM.

13 MR. WILSON: I believe the requirement you're
14 referring to is the auditor will assume responsibility
15 for, so I think these concepts are compatible in that we
16 would imagine that -- and as today in most cases the auditor
17 is assuming responsibility for that work of the other
18 auditors.

19 MR. SANTARELLI: Right.

20 MR. WILSON: Philip Johnson?

21 MR. JOHNSON: Thank you. One of the concerns I
22 have here is in regard to networks and the fact that

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1 irrespective of what we've heard, that the firms have gone
2 a long way to solving a lot of these issues over the years,
3 changed their methodologies, changed their involvement of
4 lead partners.

5 In the standard, in the proposed standard there
6 doesn't seem to be any recognition of that with regard to
7 network firms and the supervision of those network firms.
8 So as Bob said, if it's a U.K. firm, whether it's PwC or
9 KPMG, then they're treated as if it was somebody outside
10 the network.

11 That concerns me, in particular when we're looking
12 at enhancing, as Liz mentioned, the quality control
13 procedures within firms. There is common methodologies.
14 And I just sense that we may be burdening too much the lead
15 auditor and not taking into consideration the fact that
16 he or she does have influence elsewhere. The firms have
17 influence over each other in different jurisdictions.

18 And so, spending all their time supervising in
19 situations where it is almost replicated and would be a
20 similar situation if it was -- the work was being done in
21 Los Angeles for a New York partner. I just get a bit
22 concerned that the standard is just going a little bit too

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1 far and ignoring the concept of networks.

2 I did listen in on the web cast. I asked the
3 question, and David picked this up, about involvement of
4 the lead partner in other jurisdictions. And I understand
5 that firms are increasingly sending lead partners and lead
6 managers on group audits to other jurisdictions using
7 local personnel, but actually having the direct
8 supervision of the work that's being done and reviewing
9 that.

10 And I didn't see in this proposed standard that that
11 was being covered. Is it or is that deemed to be another
12 auditor, or is it deemed to be an extension? Because the
13 definition of employee seemed to indicate that it was the
14 employee in the U.S., of the U.S. firm and not the employee
15 within the network.

16 MR. WILSON: Well, I'll start. I think in the
17 situations that I understood that David was describing
18 were those in which the lead auditor had senior people
19 going to other -- going to -- let's say from; pick which
20 one's the lead auditor, the U.K. or the U.S., and going
21 from -- the lead going to the other and doing some review
22 work there and being boots-on-the-ground, if you will, in

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1 that location. And in that case they would be -- that
2 would be a supervisory action by the lead auditor under
3 our standard.

4 As to your broader question, what the attempt was
5 was to try to describe those activities that would be
6 appropriate for a lead auditor in terms of supervising and
7 being involved with supervising the work of other
8 auditors, but they hinge on the three overarching
9 principles that are in our existing supervision standard
10 today, which are risk, the nature of the work and the
11 qualifications, if you will, of the other people.

12 So they are in a sense agnostic as to whether or
13 not there is an effective network system, but I think we'd
14 be interested in comment on whether or not the extent to
15 which the -- in a network arrangement, an effective network
16 arrangement they may be achieving some of this in the
17 natural activities. I think the release does make clear
18 that we do acknowledge, as Marty said, that there are a
19 number of improvements that the firms themselves have
20 made.

21 To the extent they're already doing many of these
22 things, there's probably going to be little incremental

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1 effect on what they do under this proposal, but it's
2 conceivable that one may have a better understanding and
3 more confidence in the knowledge and skill of the other
4 auditor, and therefore that would have an impact on the
5 nature of the supervisory activities.

6 MR. JOHNSON: But it is very prescriptive though,
7 isn't it? I understand about the supervision aspect and
8 being in the current standards, but the firms have done
9 an awful lot of work to enhance their global networks,
10 their compliance within global networks. We know every
11 firm has good offices and poor offices, but the partners
12 know that. And if that work is being done, we seem to be
13 not giving any credit to the firms for all that work that
14 they have done and said you are no different than you are
15 if you're coming from outside the network and I don't have
16 any influence, or the global network doesn't have any
17 influence on the quality within that firm. That's only
18 my point.

19 MR. WILSON: Okay. Well, we'll be interested in
20 getting comment on the extent to which that's the case.
21 I think what the standard really requires is informing
22 people of what they're supposed to do, reviewing their

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1 work, seeing how the information came together and it was
2 properly coordinated. And so, I think there are
3 provisions to allow for an appropriate amount of
4 scalability, but we'll be interested in comments that we
5 get.

6 MR. BAUMANN: I just want to echo some of the
7 things. You raised a lot of good points, Philip, as
8 always, and I just want to acknowledge a couple of things
9 that Keith said there. And I was going to make the points,
10 and then he did.

11 So I mentioned the feedback loop from our oversight
12 activities yesterday in talking about our
13 standard-setting process. So to start with, over the last
14 several years our inspections of seeing many deficiencies
15 in the work performed at subsidiary locations around the
16 world by other auditors.

17 I think in response to that as part of the
18 remediation firms have done a lot to try to improve the
19 oversight by the part of the lead audit firm in, as you
20 said, visiting many of the other key locations around the
21 world, meeting with and working with those engagement
22 teams to ensure they understood the goals of the engagement

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1 team, the risks that they saw and what the expectations
2 were, making sure they had the quality people on the
3 ground, et cetera, to do that work.

4 I think our release acknowledges that first the
5 firms moved to ISA 600. That made some advances, yet there
6 was continued deficiencies. And firms have made some
7 improvements, a lot of improvements in many cases today
8 where they are doing a lot of the things that are in this
9 standard. And I think as Keith said if a firm has really
10 upped its game to that extent that they are visiting other
11 locations, giving clear instructions and direction to the
12 other auditors, obtaining key documents back to review and
13 getting the reports from those other auditors, there may
14 not be a lot of change necessary at those firms or those
15 engagements where that's happening. And that's great.

16 So if there's not a lot of cost to the system because
17 in many cases firms have remediated some of these problems
18 through inspections, that's fine. This is to bring the
19 oversight of other auditors to that high, consistent level
20 in all cases.

21 MR. WILSON: Jay Hanson, did you have a comment on
22 this?

1 MR. HANSON: Yes, I want to go back to a couple
2 things that were said about the sufficiency determination.

3 And, Brian Croteau, you were out of the room when
4 Phil raised the question. I want to go back and repeat
5 that in just a second.

6 But the point that David raised about the
7 sufficiency determination, for me personally of all the
8 things in this proposal and acknowledging that many of the
9 things that we've put in there are already in place by some
10 firms, some teams -- so we're trying to level-set for some
11 of the best practices we're seeing. But the sufficiency
12 determination is the one that should give firms the most
13 pause about how is this really going to work, and will this
14 change practice? And so, I think this is a good
15 discussion.

16 And Phil earlier raised a question, Brian, when you
17 were out of the room about the corp fin guidance on the
18 50 percent. And I want to observe that in the release and
19 the many, many pages we've got an example, a couple
20 examples of illustrations of the sufficiency
21 determination. And I have to admit that with the 45
22 versions of it I saw I'm not sure exactly which version

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1 hit the final, but I believe there's an example of one where
2 lead auditors auditing the corporate headquarters
3 consolidation and a portion of the operations, but a bigger
4 portion of the operations are audited by another firm and
5 that you could reach a conclusion that that is okay, that
6 the lead auditor is the -- say, the U.S. firm that audits
7 the corporate headquarters even though that's not more
8 than 50 percent.

9 And so, Phil's question, Brian, when you were out
10 of the room was, how does this intersect with the corp fin
11 guidance on the 50 percent?

12 MR. CROTEAU: Thanks for raising for that. I'm
13 sorry I missed the question earlier.

14 It's an important consideration to make. If from
15 a corp fin perspective, as I look at that at least, that's
16 probably an unusual place for that kind of guidance, but
17 I think it just evolved because there was not something
18 more specific in auditing standards and wanted to have
19 some guidance around the kinds of questions that corp fin
20 often was asking, or would ask from time to time, where
21 it would appear that perhaps an auditor may have been
22 involved that didn't have sufficient participation.

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1 So that's how that developed and got into the
2 guidance, but we certainly worked very closely with Marty
3 and his team as the proposal was being developed to provide
4 feedback on how we saw that kind of a -- how it developed,
5 what we saw in terms of questions and answers, the feedback
6 that we were getting through the corp fin process to
7 suggest at least what we saw as perhaps some of the
8 practices issues in the space. Ultimately we'd be very
9 interested in the public input and the feedback that the
10 PCAOB receives, but in my mind a good outcome would be
11 eventually that would go away and the guidance would be
12 in the final standard by the PCAOB. But certainly want
13 to receive feedback on that in the comment process.

14 MR. ANDRIYENKO: Brian, and also Keith responded
15 to that by saying -- recalling the actual wording from the
16 guidance, from corp fin's guidance where it says that the
17 lead auditor; I think the principal auditor in the words
18 of the guidance, should ordinarily have audited or assumed
19 responsibility for 50 percent or more of the company's
20 operations.

21 MR. CROTEAU: Yes, and it's based on facts and
22 circumstances. It's not applied as a bright line, but

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1 that's generally -- that will -- it will generate corp fin
2 comments and questions from time to time when it appears.
3 That's not been the case.

4 MR. ANDRIYENKO: I know there are a few other tent
5 cards up. I think we already started talking about sort
6 of not so much about the lay of the land, which was the
7 first slide on, but also the differences between working
8 with auditors in the same firm and auditors outside the
9 firm. So maybe it's a good time to move onto our second
10 slide and put that question up.

11 MR. BAUMANN: Keep your cards up because all of
12 these questions and issues are interrelated.

13 MR. ANDRIYENKO: Yes. Lillian, you want to
14 provide some background information?

15 MS. CEYNOWA: Sure. So working with other
16 auditors can differ significantly from working with
17 individuals in the same firm, which can pose challenges.
18 For example, the lead auditor and other auditors may work
19 in countries with different business practices,
20 languages, cultural norms and market conditions. Also,
21 different firms have different quality control systems.
22 And professional training and experience of the lead

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1 auditor may differ from those of the other auditors.

2 So the question we want to pose to you today is what
3 are your views on the challenges of working with other
4 auditors, including challenges of supervising the work of
5 other auditors participating in the audit engagement?
6 And are there additional concerns the Board should seek
7 to address?

8 MR. WILSON: Arnold Schilder?

9 MR. SCHILDER: Well, thanks, Keith. Maybe my
10 comment is even more appropriate to this question than the
11 previous one, but it basically relates to all four, of
12 course.

13 I mentioned yesterday our comprehensive
14 consultation enhancing all of the quality in this set.
15 It's professional skepticism and quality control and group
16 audits. And we roll that together because it's so
17 interrelated. And I think this discussion is just
18 illustrating that. The group audits section has over 50
19 questions that are very related to the questions that you
20 have here, so we really are dealing with the same topics
21 and issues.

22 But an illustration of why we linked it also to

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1 quality control is precisely the topic of networks. And
2 we have two questions on that specifically in the quality
3 control section. One is what could we do to address the
4 issues identified in the context of networks of firms?
5 For example, should we develop more detailed requirements
6 application material to address the reliance on network
7 level policies and procedures at the firm or engagement
8 level?

9 And the next question is do you think it will be
10 feasible for us to develop requirements and guidance for
11 networks? Please provide a basis for your views.

12 So we have put it on the agenda. And in all
13 fairness we were a bit reluctant in the beginning doing
14 so because a network is not a very tangible concept, but
15 of course it's a reality. And it's also something that
16 in the end, users will see. It's usually a network, so
17 we have auditors, et cetera. But how that works in
18 practice and how much you can make use of quality
19 management approaches in the network, that's a very
20 intriguing question. And it relates very much also to the
21 question that you have here, which is also linked to the
22 professional skepticism part.

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1 We all know the cultures and the languages --
2 challenging each other, reviewing each other. In some
3 cultures that's seen as very sensitive. Maybe it's a
4 suggestion of mistrust, which it is not. But
5 nevertheless -- so we have to take into account all of that.

6 And another related element of course is the
7 transparency that we have talked about. How much do you
8 indeed understand about these complexities? Some are
9 telling me we don't. We just see a name of a network and
10 think that's all right. But some of the questions,
11 including Bob's illustrated very well, it's even for
12 experts quite a difficult battle.

13 So we will share of course the feedback that we are
14 these days receiving on the many questions. It's very
15 impressive. Comment letters of 40, 50 pages trying to
16 answer and to inform our work.

17 And, Keith, you're very privileged because you are
18 part of our quality control group anyhow, so you will see
19 it immediately. But we also make public the comment
20 letters and collate them together per question so that
21 people see how it is.

22 And our planning is that we in December the Board

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1 will agree on the way forward of this. So not yet an
2 exposure draft. It's too complex for that. But really
3 understanding and digesting the issues, and I think it's
4 a perfect example of where again PCAOB and IAASB can
5 cooperate a lot and learn from what we are learning from
6 our others. Thanks.

7 MR. BAUMANN: I agree with that. And we're
8 looking forward to reading all of the comment letters you
9 get on that and integrating that into our thinking on this
10 project and the comment letters we get. So that's very
11 beneficial.

12 MR. WILSON: Dave Middendorf?

13 MR. MIDDENDORF: Thank you. So my comments
14 actually were originally to address question 2, but I got
15 anxious. I put my tent card up about 10 minutes ago.

16 So we've talked about some of this. Typically
17 lead auditors communicated with other auditors through
18 instructions to the lead auditor from the other auditor.
19 And then many times the lead auditor would actually go
20 visit with the other auditor team in-country to discuss
21 risk assessments, scoping, and some times review selected
22 work papers with the goal of trying to determine the

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1 competence of that team.

2 We've received inspection comments from the PCAOB
3 over the last few years relating to how did that lead
4 auditor know the other auditor was competent to perform
5 the work at high quality? So we've made some changes to
6 our processes and procedures to provide relevant
7 information to the lead auditor to give him or her the
8 appropriate information to determine the competence of the
9 auditor.

10 So you made some comments about do they have the
11 appropriate training, US GAAP, PCAOB Auditing Standards?
12 What's the results of that individual's inspections from
13 our internal inspections process and other regulators
14 around the globe? So I think maybe to Liz's comment we
15 have historically relied on if I'm the lead auditor and
16 I'm using you in the U.K., we get information to our people
17 about what's the results of our U.K. practice.

18 And I think the comments we've received from our
19 PCAOB inspections has been, well, that's great your U.K.
20 firm has the right quality control procedures, but how do
21 you know that Liz, who is your partner on a significant
22 component of your audit, that I'm going to then sign the

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1 consolidated opinion, is qualified?

2 So those are some of the processes and procedures
3 we've made changes to, which I think are very consistent
4 with the standard. And we'll certainly review the
5 standard in detail and have further comment, but we're
6 supportive of in general the philosophy behind it.

7 MR. WILSON: Thanks very much. That's very much
8 in line with some of the thinking that went into the
9 proposal. So thanks.

10 Tom Selling?

11 MR. SELLING: I'm a little bit unsure of myself
12 about this question for a couple reasons. I don't know
13 whether it fits in this category. Looking at all four
14 categories I'm not sure where it fits, so I thought I'd
15 take a stab here. And also, I want you to understand that
16 I'm primarily asking this question out of ignorance and
17 I'm looking for information.

18 My gut feel is that from an investor protection
19 perspective that one principle of this project should be
20 that the lead auditor should be the central repository for
21 all the work papers, but under the standard they're not.
22 And I'd like you to educate me as -- this seems obvious

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1 to me. I'd like you to educate me a little bit as to the
2 jurisdictional constraints you're working under to derive
3 the solution you did.

4 And my concern is that; and again, I'm not that
5 sophisticated in this area, it does appear that there are
6 opportunities to game the system, like the way you set it
7 up. For example, it seems that there have been and there
8 still are incentives to work as multiple firms solely to
9 shield working papers. And so, please answer the best you
10 can.

11 MR. BAUMANN: I just want clarification on the
12 last question, something on multiple firms. I didn't hear
13 the --

14 MR. SELLING: It seems that there are incentives
15 that -- where especially -- what I'm thinking, and this
16 kind of goes back to Rick Murray's comment earlier, is that
17 technology has changed tremendously, that the
18 availability of electronic documents and stuff like that
19 seemed to reduce the need for being in geographically
20 diverse places. And so, there's a certain irony here in
21 this standard that we're talking about working with
22 multiple firms when technology and electronic documents

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1 would make this less urgent than it used to be. And it
2 seems that the opportunity to shield working papers may
3 be a perverse incentive to work as multiple firms instead
4 of as one firm.

5 MR. WILSON: So would be interested if others
6 think that there is an issue. I would tell you that we
7 already have a standard, Auditing Standard Number 3, that
8 requires that the office issuing the report has access to
9 all the work papers. So they may not have to have them
10 physically present, but they have to have access to all
11 the work papers. Then for certain other, certain specific
12 key work papers, they're supposed to obtain -- review and
13 retain them. That's under our existing standards today.
14 The idea --

15 MR. SELLING: I'm sorry to interrupt. My
16 question is solely about document retention.

17 MR. WILSON: Yes, and that's what I'm talking
18 about. So they are supposed to be -- today the lead audit
19 firm is supposed to have access to those work papers.

20 We're interested if people think that somehow
21 there is something about the proposal that changes that,
22 but in our view those requirements, in what we refer to

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1 as Auditing Standard Number 3, remain intact. And so,
2 those obligations still exist under existing standards.
3 So we haven't changed that part.

4 What we've changed is what the lead auditor would
5 do in terms of supervising that work, which obviously
6 includes some review elements, but it hasn't changed the
7 fact that they still have to have access to all the work
8 papers.

9 MR. BAUMANN: I would just echo that again. I
10 mean, AS-3 requires that the lead auditor have access.
11 But also with respect to retention, they have to obtain,
12 retain and review key documents that are listed
13 specifically in that documentation standard, and that
14 doesn't change. So no matter where the work is being
15 performed around the world, those documents have to be sent
16 to the lead auditor as specified in that documentation
17 standard.

18 Then with respect to your comment about electronic
19 work papers, that's fine. I mean, to the extent that makes
20 the ability of the lead auditor to review some of the work
21 around the world more easy because they can get access
22 electronically to that data, that's fine. That's

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1 certainly permitted in the standard. If that enables them
2 to carry out the supervision more effectively in their home
3 office by looking at electronic papers that are sent to
4 them, that's great, or have access to.

5 Still there's a person issue, obviously. People
6 doing the work is the maybe the most important thing of
7 all. And that's why we have that important aspect of this
8 to gain an understanding of the qualifications of the key
9 people on the audits around the world who are performing
10 the work. And there's a variety of ways in which the lead
11 auditor can do that. Looking at documents, as Dave
12 mentioned, about internal inspection reports that might
13 give them knowledge of those people. Their professional
14 training and competence.

15 But often as the firms are doing, visiting those
16 key locations where the key risks of material misstatement
17 exist to meet face to face, talk with those teams is a very
18 important practice. And I think that's happening in many
19 cases, and we encourage that.

20 So all of these things come into play and we're
21 interested in the responses to that. So hopefully we've
22 answered your question, which it's not an ignorant

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1 question. It's a good question.

2 MR. SELLING: Not quite. If you don't mind, let
3 me give you a hypothetical. A restatement was necessary
4 and there's private litigation. And my question is
5 essentially how complicated is discovery? Can I rely on
6 seeking discovery from the lead auditor in the United
7 States or does discovery have to extend to part of the
8 network that's outside of the United States in order to
9 get access to all of the working papers for that engagement
10 under this standard?

11 MR. BAUMANN: Well, I commented on this during my
12 presentation yesterday that the -- it's a scope limitation
13 if the lead auditor is unable to get the work that -- to
14 see the work that they need. If they believe that they
15 need to see specific work, review specific work papers,
16 get a specific report, if they can't get it, that's a scope
17 limitation. So there isn't any shielding that takes place
18 that we can't provide this to you because of X, Y or Z.

19 If they can't send it, then the lead auditor -- it's
20 incumbent upon the lead auditor to travel to that country
21 to review those work papers, if necessary. If they're in
22 a different language, to bring a translator with them to

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1 make sure they can understand them. But there's no
2 shielding that takes place. The lead auditor has to be
3 able to get access to the people, the work to the extent
4 they deem necessary. And if they can't, then there's a
5 scope limitation.

6 MR. SELLING: Marty, I could be totally off base.
7 I'm talking about a point in time post the engagement,
8 after the engagement takes place. I could be completely
9 off base here, but I'm not talking about the lead auditor's
10 access to the working papers during the engagement. I'm
11 talking about a year later after a misstatement is
12 discovered. And in order to protect investors they need
13 to be able -- and under private securities litigation they
14 need to be discover the working papers. That's what I'm
15 talking about.

16 MR. WILSON: Okay. I'm not going to offer any
17 legal opinions about what is discoverable or not in front
18 of that. I will just say that this proposal -- I told you
19 what the standard says. And the proposal doesn't really
20 change the existing obligation for the lead auditor to have
21 access to all of the work papers, including the work papers
22 of other firms.

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1 So, Karen Nelson?

2 MS. NELSON: Yes, thank you. In reading this
3 proposal I was struck by how much discussion there was
4 regarding the incentives of the lead auditor and that this
5 proposal was going to increase incentives for supervising
6 the engagement.

7 What struck me though was that there was pretty
8 much little to no discussion of the incentives of the other
9 auditor. Where that came through was primarily in the
10 unintended consequences section where there was an
11 acknowledgement that with more responsibility to the lead
12 auditor, the other auditor may feel the possibility that
13 they could shirk, but yet the conclusion was that the
14 heightened supervision of the lead auditor would offset
15 that.

16 But when I think of this question here -- well,
17 we've moved to question 3 here, but question 2 on
18 challenges in working in this environment is the inherent
19 challenge working with an other auditor and the staff of
20 the other auditor which may not have the same incentive
21 alignment with respect to this engagement.

22 And I guess the parallel that I draw, which may or

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1 may not be exactly on point, is the idea of a substitute
2 teacher. As a substitute teacher, you have the documented
3 technical capabilities, skill set, whatever to take the
4 class, but your incentives may not be the same as if this
5 was my class to do the same job. I'm in there as a
6 substitute.

7 And so, I think of that in this situation, the
8 incentives of the other auditor. And I've talked to audit
9 staff where in some cases you want to be on the engagements
10 that are the plum local engagements for that audit location
11 where you're going to attract the attention of the partners
12 and other higher levels in that office. That's the
13 engagement to be on. Being on another engagement is
14 something where you may not get the same evaluation and
15 recognition for your skills and capabilities.

16 And so, in looking at this with respect to working
17 with the other auditors, I would encourage more thought
18 perhaps on how the incentive structure for the other
19 auditors is playing into some of these issues along with
20 just the other -- and challenges that were on the previous
21 slide.

22 MR. WILSON: Okay. Thank you very much. Those

1 are thoughtful comments.

2 I do think one of the points that we make in the
3 proposal is an observation, at least there are some
4 indications, that greater lead auditor involvement does
5 seem to affect audit quality by the firm, by the other
6 auditor firm. And so, it will be interesting -- maybe
7 further information, about whether or not that, the
8 phenomenon results from maybe changing incentives through
9 more close supervision or some other factors, but would
10 we be interested in that.

11 And your comments are well taken. Thank you.

12 MR. BAUMANN: Yes, I agree with that. And we do,
13 I think as you mentioned, Karen, note in our economic
14 analysis the principle agent relationship between the lead
15 auditor and other auditors, and the different incentives
16 they can have. There can be very different incentives on
17 the part of the lead auditor, as you said, for that plum
18 engagement versus other auditors who may be more
19 interested in the key engagements in their market, and the
20 risk of shirking is discussed.

21 And that really drives many of these requirements
22 for the lead auditor to be more engaged in the work of those

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1 other auditors and have the greater oversight to improve
2 the work of those other auditors and have higher quality.
3 So I think we're trying to get at those issues and certainly
4 interested in more comments about that. Thanks.

5 MS. NELSON: Well, if I may just follow up on one
6 comment there. I believe and I've spoken with some of my
7 colleagues that there is some research, particularly in
8 the managerial accounting area, that talks about
9 increasing the monitoring of the principle may have an
10 offsetting decrease to the agent. And so, it's not
11 necessarily clear that there were would be a net benefit
12 or a net gain by this. And that was all the point that
13 I was trying to draw.

14 MR. ANDRIYENKO: Maybe this is a good segue into
15 our third question. We're talking about the increased
16 involvement of the lead auditor into the work and
17 evaluation of the work of the other auditor. There are
18 some emerging indications that this increased involvement
19 by some of the firms produced certain results, positive
20 results.

21 And the question is about your views on whether the
22 quality of the other auditors' work in significant audit

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1 areas can be improved through increasing the lead
2 auditor's involvement in that work. So maybe some of the
3 firms can talk about their experiences. I know that David
4 and -- both Davids touched on that earlier, but if there's
5 any additional information that would be --

6 MR. BAUMANN: Three Davids.

7 MR. ANDRIYENKO: Three Davids. Thank you.

8 MR. BAUMANN: It sounds like the name of a
9 restaurant, Three Davids.

10 (Laughter.)

11 MR. ANDRIYENKO: Close to lunch.

12 MR. SULLIVAN: I just thought, since I hadn't
13 weighed in I would also weigh in with the other Daves on
14 this. Certainly as we have changed our internal --

15 MS. WATTS: Can you move your microphone closer.
16 Thank you.

17 MR. SULLIVAN: Thank you. Certainly as we've
18 changed our internal policies on the supervision of
19 component auditors, we have seen a significant improvement
20 in the quality of the work that's performed in those
21 locations, whether we measure that through our internal
22 inspections or the external inspection results of those

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1 component engagement teams.

2 But we continue to work through some of the
3 unintended consequences as well and wanting to make sure
4 that we're considering not just the short-term audit
5 quality improvement, but making sure that there's a
6 long-term sustainable model to build those skills in
7 around the world so that these audits can be performed at
8 a consistent level across the globe.

9 MR. WILSON: Phil Santarelli?

10 MR. SANTARELLI: Yes, the focus has been, and
11 appropriately so, on the lead auditor's responsibility.
12 And I'm just wondering, and this might be again in the
13 nature of a naive question, but if the component auditor
14 is auditing a significant portion of the issuer, they must
15 be registered with the PCAOB. Is that correct?

16 (No response.)

17 MR. SANTARELLI: So does the PCAOB have any
18 ability from an oversight perspective to actually do some
19 standard-setting on the other auditor's responsibility?
20 In other words, create some incentives in your rulemaking
21 where the other auditors have to cooperate or have to at
22 least interact in an appropriate way with the lead auditor

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1 versus the lead auditor kind of pulling? Is there any push
2 that can be done there?

3 This is a question that when the ASB was writing
4 AUC 600, drafting on ISA 600 -- it just occurred to me that
5 we were changing the dynamics so much and what the other
6 auditors really were expected to do. And I remember
7 saying often, should we do some standard-setting if you're
8 acting as an other auditor to enhance that cooperation and
9 so forth? And for whatever reason, we've never been able
10 to do that.

11 I don't know if it's just jurisdictional or the
12 ability to actually impose that, but certainly in the ASB
13 world that would be so because there is no -- but if they're
14 registered with the PCAOB, is there a way to kind of put
15 rules in or an expectation in for cooperation, as it were?

16 Okay. Now I understand that the global
17 networks -- I'm sure that's almost a given, but as you've
18 noted not all of these are global network-type situations.
19 So, just a thought.

20 MR. WILSON: Thanks. And the firms that do play
21 a substantial role as defined in our rules are required
22 to be registered with the PCAOB and are subject to

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1 inspection.

2 Your point about should we have some kind of
3 additional standards or guidance or something, we'll have
4 to give some thought to. And appreciate the comment.

5 Bob Herz, you've had --

6 MR. BAUMANN: Just, I'll add to that. Of course
7 if the other auditor is auditing an estimate or fair value
8 measurement in that foreign location, they're subject to
9 PCAOB standards on auditing fair value measurements with
10 respect to that. But your general comment of should there
11 be more general guidance about other auditors is something
12 for us to think about, and interested in comments on that.

13 MR. WILSON: So, Bob Herz?

14 MR. HERZ: Yes, my comments are along the line of
15 what Dave Sullivan was pointing at, but from an audit
16 committee point of view. The audit committee is really
17 important, that the lead auditor is a significant
18 component of a worldwide audit, be the right person, be
19 competent, in fact, and that the team be people who are
20 qualified and that.

21 And I think best practice is to actually make the
22 audit firm go through succession planning and the kind of

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1 things that Dave was talking about, bringing up people from
2 different parts of the international team to do rotations
3 and come to the head office as part of that audit and go
4 back to the national country. It's not something
5 necessarily you'd build into your standard, but it's all
6 those kind of considerations that really go into really
7 assuring that the worldwide audit is being done on a good
8 basis.

9 MR. WILSON: Thanks. Good points.

10 David Kane?

11 MR. KANE: Yes, thank you. I mean, certainly each
12 firm is going to be required to maintain quality control
13 standards, right, and comply with those. But when I think
14 about the journey we've been on in terms of the U.S. in
15 audit quality and all of the training and the messaging
16 and the emphasis on that, you've got very bright people
17 around the world who want to get it right but sometimes
18 need a little bit more help from primary teams to
19 understand exactly what the requirements are and the
20 specific application. Because there's one thing to think
21 just about the theory. There's another one about just
22 bringing it to life with that.

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1 So I think in that spirit there's been a lot from
2 U.S. that's been exported around the world, particularly
3 when I start thinking about the training. And I think it's
4 helpful, at least from a global network standpoint,
5 because the messaging on the tone at the top and the
6 quality, at least you understand exactly what that looks
7 like because you're living it and you know the messaging
8 that's being delivered around the world as well.

9 And you're also dealing with some structural
10 headwinds that need to be considered. In some places the
11 level of education and training, whether it be on terms
12 of accounting standards or auditing standards isn't the
13 same place as it is here. You've also got language and
14 culture barriers that need to be thought about as well
15 here.

16 So I mean, coming back to the question, I think to
17 me there's no doubt getting the lead auditor more involved
18 in terms of component teams and thinking about
19 multi-location audits has a direct impact on improving
20 audit quality.

21 MR. ANDRIYENKO: Our final question for today is
22 on the subject that came up yesterday early in the day and

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1 I would like to continue our dialogue with respect to
2 audits in which the lead auditor divides responsibility
3 for the audit with other accounting firms. And Lillian
4 would like to make a few remarks.

5 MS. CEYNOWA: Sure.

6 MR. BAUMANN: Yes, there was a lively dialogue on
7 this point yesterday.

8 MS. CEYNOWA: So I'll just throw it out there. In
9 some audits, the lead audit divides responsibility for the
10 audit with another accounting firm. For example, the lead
11 auditor may divide responsibility for the audit with
12 another auditor if it is impracticable for the lead auditor
13 to review the other auditors' work. A more specific
14 example of divided responsibility between auditors might
15 occur, could be in the year when an issuer acquires a
16 company audited by another auditor.

17 The proposal would continue to allow divided
18 responsibility in certain circumstances. What are your
19 views on whether it would be appropriate to retain the
20 divided responsibility model in PCAOB auditing standards
21 as proposed to be revised?

22 MEMBER HANSON: Lillian, before we open up can I

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1 ask you a question? So the release talks about the
2 frequency at which this happens. And so, of the roughly;
3 I can't remember the number, 15,000 to 20,000 annual
4 filings that the SEC gets every year how many of them
5 currently do this, about?

6 MS. CEYNOWA: Very good question, Jay.

7 (Laughter.)

8 MS. CEYNOWA: Audits in which the lead auditor
9 divides responsibility with one or more other accounting
10 firms is relatively uncommon. Based on our analysis of
11 SEC filings as of May of 2015 there were approximately 50
12 audits in 2014 in which the lead auditor divided
13 responsibility with another auditor.

14 MEMBER HANSON: So this discussion is about the 50
15 out of the 15-plus thousand?

16 MR. BAUMANN: I think that puts it into context.
17 An important question but a rare situation. And, but,
18 Lillian gave a good example of an acquisition being made
19 during the year, another auditor is involved and the lead
20 auditor didn't plan part of that audit and may not have
21 enough sufficient time to do that. And that might be a
22 case where -- divide responsibility and that other auditor

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1 take responsibility for their work and the lead auditor
2 for the remainder of the audit. Those are the kinds of
3 situations where that occurs.

4 MS. CEYNOWA: Now, I was just going to add in our
5 release where we talk about unintended consequences, we
6 do cite this as potential of going up because of -- some
7 may view the cost of the proposal is too high and might
8 increase the divided responsibility options. So we do
9 talk about that in the release.

10 MR. WILSON: Dave Sullivan?

11 MR. SULLIVAN: Well, you just said what I was going
12 to say, which is that -- so I don't have an answer to the
13 question, but really that question, which is to what extent
14 will this increase because of the additional
15 responsibilities imposed on the principal auditor, which
16 may be an unanswerable question, but it's an important one
17 to consider because I think it also -- it is an uncommon
18 situation today.

19 And in my personal opinion -- like if I could give
20 a disclaimer the way you do, I'd give it right now. My
21 personal opinion, I think it's probably good that it's
22 uncommon. I wouldn't want something like this to be the

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1 reason it became more common.

2 MR. WILSON: Philip Johnson?

3 MR. JOHNSON: Well, I stated yesterday what I
4 think about this subject. I don't like divided
5 responsibility. I know it's a U.S. phenomenon. There
6 are only 50. And I'm more concerned about the separate --
7 if it's felt to be acceptable and controllable, then that's
8 how it is, but to put it in a -- have a separate standard
9 for divided responsibility, which I think is the proposal,
10 it just heightens awareness of this and I just wouldn't
11 like to see the standard causing more incidents of divided
12 responsibility.

13 But having said that, I -- it is only in the U.S.
14 and it's not something that I subscribe to because I just
15 believe that the lead auditor should take responsibility
16 for the financial statements as a whole.

17 MR. BAUMANN: I think we agree, or I agree with the
18 disclaimer that I'm glad it's rare instances, as Dave
19 Sullivan said, and we raised that question specifically
20 that Lillian pointed out because we don't want the
21 unintended consequence that this greater oversight would
22 lead to a greater separation of -- or divided

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1 responsibility. And we'll take that into account if
2 people thought that were the case in our final
3 recommendation to the Board.

4 I just thought I'd ask, though, Mike, the ASB, when
5 you went through your clarification project post the
6 IAASB, which doesn't have the divided responsibility, I
7 do believe the ASB, while adopting essentially the
8 principles of ISA 600 nevertheless did continue to permit
9 divided responsibility. Am I right there? And if so, I
10 was wondering what your thinking might have been.

11 MR. SANTAY: Yes, we did. And I think as we go
12 through the process of clarification and convergence,
13 which is still one of our main objectives, convergence with
14 IAASB, we also look at differences, jurisdictional
15 differences that we think are important.

16 Obviously, the SEC allowed divided
17 responsibility. There are certain situations -- I think
18 you highlighted them in the discussion yesterday, where
19 there's operational challenges where the Board felt that
20 it was important to differ from the IAASB. I don't think
21 we have many differences in the Group Audit Standard.
22 Obviously, that's a fairly significant one, but it's one

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1 that in our assessment of the ITC that's come out that
2 Arnold's -- the IAASB has issued, our comment letter is
3 still supporting a divided responsibility regime.

4 MR. BAUMANN: Thank you.

5 MR. WILSON: Yes, and I'd just say so far there
6 seems to be a strong sense of, well, if we're going to have
7 these, let's keep them rare so any comments anyone might
8 have, either today or in -- hopefully we'd appreciate any
9 written comments on ways to continue to do that. That is
10 one of the questions we're asking. Should we keep it and
11 should we place -- what kind of limitations or additional
12 limitations should we put that.

13 Liz Murrall?

14 MS. MURRALL: Yes, thank you. Well, as I've said,
15 I mean, investors really believe that the lead auditor
16 should take responsibility for the audit and the judgments
17 in that audit. And as regards divided audit
18 responsibility, as we've heard, it's not required
19 internationally. It's not allowed internationally. And
20 I just fear that it could be perceived that sort of lesser
21 standards were being applied here. I don't think that's
22 necessarily the case, but it could be perceived.

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1 Investors do invest internationally and consistent
2 reporting requirements under this would be welcome.

3 MR. WILSON: Okay. Thanks. Bob Herz, you get
4 the last word on this.

5 MR. HERZ: Yes, I just kind of wondered whether the
6 instances of divided responsibility might increase over
7 time given the E.U.'s requirements on mandatory auditor
8 rotation. So if I posit a situation where a U.S. company
9 that has significant European operations would wish to
10 retain its overall U.S. auditor, but says I'm fine saying
11 PwC in the U.S. and E&Y in Europe and the audit report
12 reflecting that.

13 So I don't know whether it's good or bad, or
14 whatever. I'm just thinking that could increase the
15 number of those situations.

16 MR. BAUMANN: I think it's an important factor and
17 interested in comments that people might have on that as
18 that takes place over in Europe and as the mandatory
19 rotation kicks in.

20 Sir David Tweedie, did you want to respond?

21 MR. TWEEDIE: Not to that, Marty. I was just
22 going to ask Arnold, did this issue come up in the IAASB,

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1 and what was the reaction when I suppose some of the
2 American members put this forward?

3 MR. SCHILDER: We have asked a question about it
4 as a result of the discussions that we had also looking
5 to the U.S. situation. So we are currently awaiting the
6 comments. What I've seen so far is there's not much
7 appetite for reference in this way to other auditors, but
8 we still have to look at the comments in total. My guess
9 is it will be unlikely that we will change the principle.
10 But nevertheless, for example, some comments are pointing
11 to the situation which I think is in your documents, as
12 well. Equity investments, difficult to audit. So should
13 that be a reason that the overall principle as a result --
14 which had -- delete all the -- taking full responsibility
15 for a full audit is a very key principle. But
16 nevertheless, we've asked the question.

17 MR. TWEEDIE: And with Lillian's question about
18 the acquisition very late in the year and another auditor
19 has been doing all the planning and working, how does the
20 IAASB deal with that?

21 MR. SCHILDER: We haven't discussed this specific
22 example. Still, starting from the point you have to do

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1 what you can to understand and review that audit yourself
2 to the extent that you basically can take over. So likely;
3 I say Marty pointed to that yesterday, it might be that
4 that's not possible, or have a scope limitation or so
5 disclaim from an opening balance sheet or so. That will
6 be more in line with that principle. But nevertheless
7 it's an interesting example.

8 MR. ANDRIYENKO: I think on that note, I'm just
9 going to thank you for the discussion today. Thank you
10 for comments and views. They will certainly guide us in
11 our next steps as we move towards finalizing the proposed
12 rule. We also encourage investors and investor
13 advocates, auditors, preparers, other constituents to
14 send us comment letters on the proposal.

15 On the screen in front of you, there is a slide
16 reminding you of how and where to submit your comment
17 letters. The comment period will be open for another two
18 months and a bit until July 29th.

19 And with that, I'm going to turn this back over to
20 Marty. Thank you.

21 MR. BAUMANN: Thanks, Dima and Lillian and Keith,
22 for -- and all the SAG members for a very thorough and good

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1 discussion on this very important proposal on supervision
2 of other auditors.

3 I'm going to keep with tradition on the SAG
4 Chairman's wrap-up and do that in about 30 seconds, as
5 people are anxious and eager to catch lunch, planes,
6 travel, et cetera.

7 So we got a lot of great information from you on
8 the various different standards that we've proposed, the
9 emerging issues that we need to address. And it's been
10 just another excellent discussion, and we appreciate very
11 much your involvement.

12 So thanks. Safe travels. And you'll be hearing
13 from us again very soon.

14 Chairman Doty, I think, wants to make a remark.

15 CHAIRMAN DOTY: I just wanted an additional 15 or
16 20 seconds to thank the SAG members for what I think has
17 been an extraordinarily productive and stimulating SAG
18 meeting. The presentations, the breakout sessions, the
19 general good humor and good will, and also the really quite
20 helpful and insightful information we got is going to be
21 very useful to us. Thank you, all, for doing this.
22 Thanks to the chief auditor and his staff for putting this

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1 together. Well done. Thank you.

2 MR. BAUMANN: Okay. Good day, everybody.

3 (Whereupon, the above-entitled matter went off the
4 record at 12:29 p.m.)

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NOTICE: This is an unofficial transcript of the portion of the Public Company Accounting Oversight Board's Standing Advisory Group meeting on December 1, 2016 that relates to *Proposed Amendments Relating To The Supervision of Audits Involving Other Auditors And Proposed Auditing Standard—Dividing Responsibility for the Audit With Another Accounting Firm*. The other topics discussed during the November 30-December 1, 2016 meeting are not included in this transcript excerpt. The Public Company Accounting Oversight Board does not certify the accuracy of this unofficial transcript, which may contain typographical or other errors or omissions. An archive of the webcast of the entire meeting can be found on the Public Company Accounting Oversight Board's website at: <https://pcaobus.org/News/Events/Pages/SAG-meeting-November-2016.aspx>.

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PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

+ + + + +

STANDING ADVISORY GROUP

+ + + + +

MEETING

+ + + + +

THURSDAY,
DECEMBER 1, 2016

+ + + + +

The Advisory Group convened in Academy Hall in the headquarters of FHI 360, located at 1825 Connecticut Avenue, NW, Washington, DC, at 8:30 a.m., Marty Baumann, Moderator, presiding.

PRESENT:

- JOAN C. AMBLE, President, JCA Consulting, LLC
- PRAT BHATT, Senior Vice President, Corporate Controller and Chief Accounting Officer, Cisco Systems, Inc.
- PETER C. CLAPMAN, Senior Advisor, CamberView Partners, LLC
- CHARLES M. ELSON, Edgar S. Woolard, Jr. Chair of Corporate Governance and Director, John L. Weinberg Center for Corporate Governance, University of Delaware
- MICHAEL J. GALLAGHER, Managing Partner, Assurance Quality, PwC
- SYDNEY K. GARMONG, Partner in Charge, Regulatory Competency Center, Crowe Horwath, LLP
- KENNETH A. GOLDMAN, Chief Financial Officer, Yahoo, Inc.
- L. JANE HAMBLIN, Former Chief Legal Counsel, State of Wisconsin Investment Board
- ROBERT B. HIRTH, JR., Chairman, Committee of

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Stewardship, Standard Life Investments, Ltd.

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Professional Practice, Ernst & Young, LLP

SARA GROOTWASSINK LEWIS, Chief Executive Officer, Lewis
Corporate Advisors, LLC

JON LUKOMNIK, Executive Director, Investor Responsibility
Research Center Institute; Managing Partner,
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DOUGLAS L. MAINE, Limited Partner and Senior Advisor,
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Accounting, Stanford University

DAVID J. MIDDENDORF, National Managing Partner-Audit
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Dynamics Consulting, LLC

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Texas Christian University

ZACH OLEKSIUK, Americas Head, Corporate Governance and
Responsible Investment, BlackRock

GREGORY A. PRATT, Chairman, President and Chief
Executive Officer, Carpenter Technology
Corporation

SRIDHAR RAMAMOORTI, Associate Professor of Accounting,
School of Accountancy and Director, Corporate
Governance Center, Kennesaw State University

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SIR DAVID P. TWEEDIE, Chairman, International
Valuation Standards Council
CULLEN WALSH, on behalf of Larry Smith of the FASB
JOHN W. WHITE, Partner, Corporate Department,
Cravath, Swaine & Moore, LLP
MEGAN ZIETSMAN, on behalf of Arnold Schilder of the IAASB

PCAOB BOARD MEMBERS:

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PCAOB STAFF:

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MARTIN F. BAUMANN, Chief Auditor and Director of
Professional Standards
JAMES R. DOTY, Chairman
STEPHANIE HUNTER, Assistant Chief Auditor
DENISE MUSCHETT WRAY, Assistant Chief Auditor
JESSICA WATTS, Associate Chief Auditor
KEITH WILSON, Deputy Chief Auditor

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1 MR. ANDRIYENKO: Thank you, Marty. We are happy
2 to give you an overview of comments on the proposal on the
3 supervision of other auditors. I am going to go through
4 a few introductory slides and I am going to turn it over
5 to my colleagues after that.

6 Joining me for the presentation today are Denise
7 Muschett Wray and Stephanie Hunter to my right. They have
8 put a lot of effort in preparing the proposal. Now we have
9 been all working hard together analyzing comments in the
10 comment letters. Also at the table is Deputy Chief
11 Auditor Keith Wilson, who also works on the proposal.

12 I am going to put the slide up. I am not going to
13 go through the standard disclaimer. I just wanted to
14 note, perhaps stating the obvious, that our presentation
15 is a fairly high-level overview of comments. The actual
16 comment letters in their entirety are, of course, on our
17 website in Rulemaking Docket 42.

18 This slide is a very brief refresher on the project.
19 The proposal was issued on April 12th this year. It was
20 designed to increase the lead auditor's involvement in an
21 evaluation of the work of other auditors, also to enhance
22 the lead auditor's ability to either prevent or detect

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1 deficiencies in the work of other auditors, and
2 ultimately, to facilitate improvements in the quality of
3 work of other auditors.

4 The proposal builds on the existing requirements
5 in PCAOB standards. It would amend several of the
6 existing standards, namely standards of supervision,
7 planning, the engagement of quality review, and
8 documentation. It would supersede one of the existing
9 PCAOB standards, the one that has been on the books since
10 the early 1970s and currently governs some of the audits
11 that involve other auditors, that is AS 1205 or, as we
12 currently know it, AU 543.

13 And finally, the proposal would provide a new
14 auditing standard for situations in which the lead auditor
15 divides the responsibility for the audit with another
16 accounting firm. So, this is a proposed standard 1206.
17 And currently, these audits are governed by AS 1205.

18 On this slide, you can see who actually commented
19 on the proposal. The PCAOB received 23 comment letters,
20 most of which came from the accounting profession, the
21 accounting firms and associations of accountants.

22 The proposal included almost 60 fairly detailed

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1 questions to commenters and we did receive some very
2 detailed responses to our questions. Many of the
3 commenters responded to either every single question or
4 covered all of the key areas of the proposal. And we are
5 currently going through the comments. We are analyzing
6 the comments. Our discussions are still ongoing within
7 the team and within the PCAOB.

8 Just a few words about general themes in comments.
9 In general, commenters agreed with the stated reasons in
10 the proposal for amending auditing standards and also with
11 the general direction that the proposal took, which is to
12 require that the lead auditor uses risk-based approach to
13 supervising other auditors. And that is important for
14 determining the appropriate extent of supervision of the
15 other auditor, appropriate extent of involvement in the
16 work of other auditors and evaluation of their work.

17 And you can see on the slide the commenters said
18 that -- some commenters said that many of the proposed
19 changes are a step in the right direction, that it would
20 improve the quality of audits, and enhance investor
21 protection. But there are comments that indicated
22 concern whether the proposal really strikes the right

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1 balance between the lead auditor's involvement in the
2 audit and the other auditor's involvement in the audit.
3 And even those who supported the overall direction of the
4 proposal were asking questions and asking for
5 clarification on certain aspects of the proposal and then
6 making suggestions in their comment letters. And we are
7 going to go through those comments, as we go through the
8 presentation.

9 These are the key areas of comment that we thought
10 we would cover today. We would start, naturally, with
11 audit planning, which includes several proposed
12 requirements, including the sufficiency of ---
13 requirements for determining sufficiency of the lead
14 auditor's participation in the audit, requirements
15 related to determining compliance of --- the other
16 auditor's compliance with ethics and independence,
17 requirements of the PCAOB and the SEC, and the assessment
18 of the knowledge, skill, and abilities of the other
19 auditor.

20 Then, we will move on to comments related to
21 supervisory requirements in the proposal. We will talk
22 about the divided responsibility audits, that is the new

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1 proposed standard, and the requirements for the engagement
2 quality review.

3 Then, we will talk about a potential unintended
4 consequence of the proposal, whereas, the other auditor
5 may feel a little less accountable for their work, now that
6 the lead auditor is going to be more involved in the audit.

7 And we will conclude with discussing comments and
8 various aspects of the economic analysis.

9 I am going to turn the mike over to Denise. She
10 will cover the area of planning and she will talk about
11 some of the supervisory requirements. And then Stephanie
12 will continue on. She will wrap up the supervision and
13 cover the rest of the topics.

14 MR. BAUMANN: And I just wanted to point out some
15 may not be clear in the slides up there on the screen.
16 Everybody should have a copy of these slides in their
17 folder.

18 MS. WRAY: Thank you, Dima. Good morning,
19 everyone. As Dima indicated, I will go over with you
20 comments we received on the proposed requirements related
21 to planning an audit that involves the use of other
22 auditors. So, it is proposed amendments to AS 2101 as well

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1 as comments we received on a couple of the proposed
2 requirements related to supervision of the work of the
3 other auditor.

4 And so on this first slide, we have summarized
5 comments we received relating to a proposed requirement
6 that the engagement partner determines whether his or her
7 firm is sufficiently involved in the audit to serve as lead
8 auditor. The determination would be based on the risk of
9 material misstatement associated with the portion of the
10 financial statement audited by the engagement partner's
11 firm relative to the portion audited by the other auditors.

12 Ordinarily, the lead auditor would need to audit
13 the location at which the primary financial reporting
14 decisions were made and the consolidated financial
15 statements were prepared in order to address the risk
16 related to these very important judgments and activities.
17 As well, the auditor would need to audit a sufficient
18 number of other locations to cover the greater portion of
19 risk than any other audit firm that is involved in the
20 audit.

21 As we can see on the slide, some commenters
22 indicated that an auditor should not issue an opinion when

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1 not sufficiently involved in an audit and that describing
2 the sufficiency criteria in the standard, in terms of risk,
3 is appropriate.

4 Several commenters were concerned whether the
5 proposed requirements could be effectively applied to
6 certain situations they encountered in practice. Some of
7 these commenters asked the Board to provide more examples
8 in the release to illustrate how these scenarios would be
9 addressed by the amendments. For example, some
10 commenters asked to clarify how the proposed requirements
11 would apply when one auditor audits a significant portion
12 or a sizeable portion of the company or when more than one
13 auditor audits a sizeable portion of the company.

14 A few commenters asked us to clarify whether the
15 lead auditor's close supervision of another auditor could
16 be counted towards the lead auditor's participation in the
17 audit.

18 Several commenters asked questions about
19 situations in which the auditor who meets the sufficiency
20 criteria is not licensed in the jurisdiction of the
21 issuer's headquarters. For example, if the issuer is
22 headquartered in a U.S. state that requires the auditor

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1 to be licensed in that state, commenters asked the Board
2 to provide more explanation about how the requirements
3 would be implemented in those situations.

4 The second comment theme relating to audit planning
5 addresses the proposed requirement for the lead auditor
6 to determine the other auditor's compliance with ethics
7 and independence requirements of the PCAOB and the SEC.
8 The proposal would require the lead auditor to gain an
9 understanding of the other auditor's knowledge of and
10 experience in applying the ethics and independence
11 requirements and obtain a written representation of
12 compliance from the other auditors.

13 The proposed requirement is intended to provide the
14 lead auditor with specific direction for complying with
15 existing requirements for planning an audit that involves
16 other auditors. Several commenters supported obtaining
17 from other auditors a written representation of compliance
18 with ethics and independence requirements.

19 We do note, however, that some commenters observed
20 that when read in conjunction with the proposed definition
21 of other auditor, the use of other auditor in this
22 particular requirement could be interpreted to mean that

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1 the lead auditor would need to obtain a written
2 representation from each individual engagement team
3 member who is not employed with the lead auditor.

4 Several commenters also recommended clarifying
5 whether the lead auditor can rely on the quality control
6 system of another auditor from the same audit network when
7 determining which procedure the lead auditor should
8 perform to comply with the proposed amendments.

9 This slide shows the last set of comments on the
10 proposed requirements related to planning that we will
11 discuss and it relates to those requirements for the lead
12 auditor's understanding of the knowledge, skill, and
13 ability of certain engagement team members at the other
14 auditor.

15 Commenters generally agreed that understanding the
16 qualifications of the other auditor is important when the
17 lead auditor determines the extent of its supervision of
18 the work of other auditors. However, this is also an area
19 for which commenters wanted to know if the lead auditor
20 may rely on its network's quality control system when the
21 other auditor and the lead auditor are in a common network.

22 For this particular requirement, commenters

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1 thought that the lead auditor should be able to rely on,
2 for example, information regarding their network's
3 training policies and programs.

4 Some commenters thought that the proposed
5 requirement should apply only to those engagement team
6 members at the other auditor who assists the engagement
7 partner with planning and supervision. Other commenters
8 thought the requirement should be expanded to apply to
9 other engagement team members of the other auditors.

10 Commenters who were in favor of expanding the
11 requirement were concerned, for example, that, as
12 proposed, the requirement does not contemplate those
13 engagement team members of the other auditor's firm who,
14 although not assisting the engagement partner with
15 planning and supervision, perform work that is significant
16 to the audit.

17 Specialists who are part of other auditor's team
18 and perform work that is significant to the audit as a whole
19 were cited as an example of where expansion of this
20 requirement could, in the views of those commenting, lead
21 to improvement in audit quality.

22 One commenter suggested that the Board consider

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1 allowing the lead auditor to determine on a case-by-case
2 basis whether to apply this requirement only to those
3 engagement team members assisting with planning and
4 supervision or to other engagement team members on the
5 other auditor's team.

6 With this slide, I will now switch gears to the
7 proposed requirements related to supervising the other
8 auditor's work. Before jumping into the actual themes,
9 it may be worth repeating that the proposed requirements
10 are intended to build on existing supervision requirements
11 that are in our standards for the work of other auditors
12 and it is intended to give the lead auditor more specific
13 directions in terms of how to comply with existing
14 standards, existing requirements.

15 With that, the first comment theme that we have on
16 this slide relates to the proposed requirement for the lead
17 auditor to inform the other auditors in writing about their
18 responsibilities. Some commenters were generally in
19 agreement that written communication of the lead auditor's
20 instructions to other auditors would improve audit
21 quality.

22 Some commenters were unclear as to whether the lead

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1 auditor's communication should include all the risks or
2 only those relevant to the other auditor's work. The
3 commenters who had this concern indicated that requiring
4 the lead auditor to communicate all risks would be too
5 broad of a requirement and could result in significantly
6 more work.

7 The second half of the slide deals with comments
8 on a proposed requirement for the lead auditor to obtain
9 from other auditors a written report that would describe
10 the other auditor's procedures, findings, conclusion, and
11 where applicable, opinion.

12 We noted that the intended scope of this particular
13 communication appeared to be unclear for some commenters.
14 Some commenters, for example, discussed scaling this
15 requirement to the scope of the other auditor's work. One
16 commenter noted that for certain circumstances, the Board
17 could consider allowing the lead auditor to conduct
18 discussions with the other auditor and perform a more
19 detailed review of the other auditor's work as an
20 alternative to this written report.

21 Other commenters asked whether the Board intends
22 for the other auditor to report to the lead auditor a

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1 summary of each procedure performed by the other auditor
2 or provide a more risk-based reporting of procedures
3 performed to address high-risk areas. Some of those who
4 commented on this requirement asked for additional
5 guidance on the form and content of this written report.

6 This slide has the last area that I will cover for
7 you and it relates to the proposed requirement for the lead
8 auditor to review a description of other auditors' planned
9 audit procedures and the results of the other auditor's
10 work.

11 Some commenters noted a few areas in which these
12 proposed requirements could be clarified. For example,
13 some commenters noted that a requirement for the lead
14 auditor to review detailed audit programs of the other
15 auditor would be too onerous, especially when the other
16 auditor is performing a full-scope audit.

17 Some commenters asked that the Board consider
18 allowing the lead auditor to better leverage the review
19 performed by partners and managers of the other auditor's
20 firm who are experienced and well-qualified. One
21 commenter asked that the Board clarify the application of
22 the review requirement in certain circumstances, such as

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1 when the lead auditor uses a translator for work that has
2 been documented in a foreign language.

3 Lastly, several commenters ask whether the lead
4 auditor may leverage its network quality control system
5 -- again, as you can see, this is a common question -- in
6 determining the extent to which it performs these
7 requirements for other auditors within the lead auditor's
8 network.

9 I will now turn it over to Stephanie to complete
10 the other supervision comments in the other areas.

11 MS. HUNTER: Thank you, Denise.

12 Okay, so I will cover the final comment theme
13 relating to the lead auditor's supervision of other
14 auditors. And specifically, I am going to discuss the
15 comments on the supervisory requirements for multi-tiered
16 audits.

17 To review the proposal, in an audit involving
18 multiple tiers of other auditors, the proposal would allow
19 the lead auditor to direct the first other auditor to
20 perform, on behalf of the lead auditor, certain
21 supervisory procedures with respect to the second other
22 auditor.

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1 Certain other supervisory procedures should be
2 performed by the lead auditor, such as communicating scope
3 of work, tolerable misstatement and risk of material
4 misstatement.

5 As you can see on the slide, commenters generally
6 view the involvement of first-tier other auditors in
7 supervising lower-tier other auditors as important
8 because of the first-tier other auditor's knowledge of
9 company business at their level.

10 Some commenters suggested allowing for greater
11 involvement of first-tier other auditors and supervising
12 lower-tier other auditors. For example, allowing the
13 first-tier other auditor, rather than the lead auditor,
14 to perform supervisory procedures for the next tier other
15 auditors.

16 Another commenter suggested requiring the lead
17 auditor to obtain information about the first-tier other
18 auditor's supervisory decisions as part of the lead
19 auditor's supervision of the first-tier other auditor.

20 Some commenters recommended clarifying how
21 proposed requirements would apply when an audit involves
22 more than two tiers of other auditors.

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1 So, now we have covered the key areas of the
2 comments related to the proposed amendments on planning
3 and supervision. So, I want to move on to some of the other
4 comments and specifically we are now going to cover the
5 new proposed standard for divided responsibility audits.

6 As Dima introduced earlier in this session, in some
7 situations the lead auditor divides responsibility for the
8 audit with another accounting firm that audited and issued
9 an audit report on the financial statements of a portion
10 of a company. For example, the lead auditor may divide
11 responsibility for the audit with the other auditor if it
12 is impracticable for the lead auditor to review the other
13 auditor's work. And those divided responsibility
14 situations are relatively uncommon. As you see on the
15 slide, there were approximately 50 of these such audits
16 in fiscal year 2014. So, it is relatively uncommon.

17 When the responsibility for the audit is divided,
18 the lead auditor discloses that fact in its report on the
19 consolidated financial statements.

20 The proposal includes a new separate auditing
21 standard, as Dima mentioned earlier, AS 1206, specifically
22 for these divided responsibility audits. Proposed AS

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1 1206 would maintain the requirement that the lead auditor
2 disclose in its report which portion of the financial
3 statements was audited by the other auditor or, in the
4 terminology of the proposal, the referred to auditor.

5 Commenters generally supported retaining the
6 auditor's ability to divide responsibility and provided
7 some specific comments and suggestions for the proposed
8 standard. One area, as you will see on this slide, where
9 the proposed new standard describes conditions that must
10 be met for the lead auditor to divide responsibility for
11 the audit with another accounting firm.

12 One of these conditions, under the proposal states
13 that the lead auditor may divide responsibility only if
14 the financial statements of the company's business unit
15 audited by the referred to auditor were prepared using the
16 same financial reporting framework as the framework used
17 to prepare the company's financial statements.

18 According to some commenters, such situations
19 exist today and may become more prevalent in the future
20 because of broad use of IFRS and expected increased
21 rotation of auditors involved in international audits. I
22 will also note that both the SEC Staff's Financial

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1 Reporting Manual and ASB's AU-C Section 600 address these
2 situations.

3 Therefore, the commenter suggested that the
4 proposed standard allow division of responsibility when
5 the company and its subsidiary used different financial
6 reporting frameworks.

7 Lastly, some commenters recommended providing
8 certain clarifications and examples relating to applying
9 the proposed standard in integrated audits.

10 Our next slide addresses the Board's proposal,
11 including an amendment to the standard on the engagement
12 quality review, AS 1220 or currently AS 7.

13 Under the proposed amendment, the engagement
14 quality reviewer would be required to evaluate the
15 engagement partner's determination that the participation
16 of his or her firm is sufficient for the firm to carry out
17 the responsibilities of a lead auditor. And Denise
18 covered comments earlier regarding the determination of
19 sufficiency.

20 As for the proposed requirement for the EQR, some
21 commenters supported the requirement as proposed, while
22 some commenters question whether the determination of

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1 sufficiency is always a significant judgment and thus
2 should always be reviewed by the engagement quality
3 reviewer.

4 Our next topic relates to a potential unintended
5 consequence Dima brought up earlier and it is discussed
6 in the Board's proposal. And this is relating to the other
7 auditor's accountability.

8 Here, the proposal would supersede, as we have
9 mentioned before, AS 1205, currently AU 543, and would not
10 retain a statement that, quote, "the other auditor remains
11 responsible for the performance of his own work and for
12 his own report."

13 To mitigate the potential unintended consequence
14 that the other auditor could feel less accountable, the
15 proposal includes a requirement that the lead auditor
16 obtain from the other auditor a written report describing
17 the other auditor's procedures, findings, conclusions,
18 and, if applicable, opinion. And Denise discussed this
19 earlier.

20 Notably, under the proposal, the other auditor
21 would continue to remain responsible for, among other
22 things, obtaining sufficient appropriate audit evidence

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1 to support its written report describing the other
2 auditor's procedures, findings, conclusions and, if
3 applicable, opinion. Some commenters said that not
4 retaining a statement about the other auditor's
5 accountability in AS 1205 would imply a free pass to other
6 auditors regarding the quality and sufficiency of their
7 work. The potential reduction in accountability of the
8 other auditor, whether actual or perceived, may adversely
9 affect audit quality. For example, because the other
10 auditor could be in the best position to supervise the
11 day-to-day responsibilities of a portion of the audit
12 performed by other auditors.

13 Some commenters suggested that the Board retain in
14 the standards a statement that other auditors are
15 responsible for their work.

16 Okay, so my final area of discussion is on certain
17 aspects of economic analysis. Again, as Dima introduced
18 earlier, we will discuss certain aspects of the analysis.
19 As a reminder, the proposing release includes an economic
20 analysis that described the baseline for evaluating the
21 economic impacts of the proposal, analyze the need for the
22 proposal, and discuss potential economic impacts of the

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1 proposed requirements, including the potential benefits,
2 costs, and unintended consequences. The analysis also
3 discussed alternatives considered.

4 With respect to the description at baseline and
5 need for the proposal and the proposing release,
6 commenters generally agreed that changes in the business
7 environment, company, an audit firm structure,
8 regulation, and financial reporting standards support the
9 need for change. For example, commenters agreed with the
10 need to update PCAOB standards by integrating the
11 requirements for using other auditors into the risk-based
12 approach.

13 Commenters generally agreed with the description
14 of existing audit practice in the proposal and provided
15 additional relevant information. For example, several
16 firms acknowledged that they have already updated their
17 methodologies for audits involving other auditors.

18 With respect to the description of economic impacts
19 in the proposing release, including benefits and costs,
20 some commenters provided information in support of the
21 description of potential benefits. One commenter stated
22 that the proposed amendments would provide more

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1 transparency about audits involving other auditors and
2 would, therefore, benefit investors and the public.

3 Another commenter said that the proposed changes
4 should decrease the overall likelihood of misstatement by
5 enhancing the verification process of information relied
6 upon by other auditors and, therefore, should serve as
7 added safeguards for the investors and general public
8 through their ability to rely on the financial statement
9 data and related disclosures.

10 As in the example Denise gave earlier, some
11 commenters asked whether certain proposed requirements
12 are designed to be sufficiently scalable based on risk.
13 If not, the commenters caution that the amendments could
14 be unnecessarily burdensome without corresponding
15 benefits to audit quality.

16 Some commenters also caution that some smaller
17 firms could face more significant cost increases than
18 larger firms. And as a result, some firms could determine
19 that they would no longer perform audits that require the
20 involvement of another audit firm.

21 And now I am going to turn it back to Dima.

22 MR. ANDRIYENKO: Okay, thank you very much Denise

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1 and Stephanie for your presentation. As you can
2 appreciate, the proposal is covering a lot of ground. It
3 touches on several key audit areas and would amend many
4 of the existing key auditing standards.

5 As I said, we asked many questions in the proposal,
6 almost 60, and we got a lot of comments. We are going
7 through these comments today. We were going through the
8 comments at the PCAOB but if you have additional comments
9 and any questions, please feel free to put up your tent
10 card and we will call on you. We had a fairly lively
11 discussion of this topic back in May, when the proposal
12 just went out, and we are happy to continue today. Sri.

13 MR. RAMAMOORTI: If you could take this slide back
14 to the reference to [AS] 1205.03, just a couple more.

15 Yes, so when I read that, it is obviously
16 gender-biased usage. So, I just want to point out that
17 I am glad that section is going out. Hopefully, you will
18 be replacing it with better language. But I should just
19 point out in general that when I first started teaching
20 in the United States, about 60 percent of my students were
21 young men and 40 percent were women. Now, it is exactly
22 the opposite. It is about 60 percent women in my classes

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1 and 40 percent men.

2 And so I tell you to be very careful. Do not use
3 his or her unless you want to say he and she and all that,
4 which of course is very painful. So, I propose to them
5 a solution which I did in my Ph.D. dissertation, which is
6 make a note that this is being used as an epicene personal
7 pronoun, which means depending on context you read the his
8 as a her if that is relevant.

9 MR. ANDRIYENKO: Yes, thank you for this comment.
10 This was written in the dark days of standard-setting back
11 in the '70s. As you can see, I think you can even
12 appreciate it looking at us who are presenting at this
13 table, we are cognizant of this issue. And you will
14 probably not see it in our standards but thank you, Sri.

15 Liz Murrall.

16 MS. MURRALL: Thank you very much. And thank you
17 very much for your work in this area and increasing the
18 supervision -- your requirements for the supervision of
19 other auditors. I think that is very welcome.

20 Investors invest internationally and their
21 preference would be for harmonized requirements to apply
22 internationally for audit. But I note that whereas the

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1 PCAOB is allowing divided responsibility and a reference
2 to be made to that in the audit report, the same is not
3 allowed by the IAASB in ISA 600. And, indeed, even in the
4 U.K. where we have ISA 600-plus, we go on to say the group
5 engagement partner's firm bears the full responsibility
6 for the auditor's report on the group financial
7 statements.

8 I mean both the IAASB and the PCAOB address the
9 audits of multinational companies but I question why you
10 need to have a different approach because I think for many
11 investors, divided responsibility would be seen as a
12 limitation in scope.

13 MR. BAUMANN: I will just comment on that briefly.
14 Again, it exists today in current standards in the United
15 States. So, we have put this out as a proposal to see how
16 people react to it.

17 And I think maybe Megan can comment on this. I have
18 heard, as I have sat at the IAASB CAG, as they have thought
19 about ISA 600, the group audits, that there are situations
20 where the lead auditor just doesn't have access to the
21 audit work of an equity investment or something like that,
22 which is part of the financial statements.

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1 So, should the lead auditor still sign the opinion
2 of the consolidated financial statements, even though he
3 or she cannot potentially audit 100 percent of the work,
4 or should the divided responsibility exist, or should
5 there be some other solution? So, I think it is something
6 we are exploring as part of the proposal and I'm not sure
7 where we will come out on this at the end of the day. But
8 there are relatively few situations today.

9 Megan, is this something where you have heard some
10 issues at the IAASB?

11 MS. ZIETSMAN: Yes, Marty, thanks. And it
12 definitely is something that is on the IAASB's list of
13 issues. I think, as you know, we have an ongoing project
14 to look at our group audit standard and we did a very
15 significant consultation where we put out all of those
16 issues, which included some questions around the issue of
17 divided responsibility. I mean Liz is right, that [ISA]
18 600 today does not provide for the ability to divide
19 responsibility or make reference to the report of another
20 auditor in the report.

21 But what we heard -- actually, I will just take a
22 step back. When the IAASB started its project, their

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1 intent was not to open up that debate because that had been
2 a very hotly debated issue when ISA 600 was first finalized
3 and I think actually was the issue that contributed to that
4 standard having to be re-proposed a couple of times before
5 it actually got finalized.

6 So, our intention was not to open up that can of
7 worms all over again but it did come out as we started to
8 explore the issues. And like you pointed out, there are
9 situations like an equity method investment where you just
10 don't have the same kind of access at management level,
11 as well as at the audit level to really be able to do it.

12 And I think actually it was at the CAG that one of
13 the CAG members put the question on the table that if you
14 have a situation where you have an equity method investment
15 that is, itself, a listed company that is audited, that
16 has a stand-alone auditor's report, that investors are
17 using to make investing decisions about with respect to
18 that company, why then would it not be permissible to have
19 a reference in the report of the company that has an
20 investment in that company to that report. And maybe that
21 would be preferable to putting the auditor in somewhat of
22 an artificial position where you really don't get the same

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1 kind of access that you might when it is a component.

2 So, the IAASB has received a lot of feedback and
3 I think, like Liz pointed out, I think there is a very
4 strong view that sole responsibility is the way that it
5 should be and that we shouldn't open up this issue. But
6 the IAASB still has to go through the process of fully
7 digesting all the feedback and deciding whether there is
8 actually a narrow set of circumstances where divided
9 responsibility may make sense.

10 And the other situation that has been put on the
11 table is the situation where you have a transaction or an
12 acquisition that happens really late in the year and it
13 is very difficult for the auditor of the acquiring entity
14 to really do everything that needs to get done.

15 So, I think the jury is still definitely out but
16 it continues to be a big issue.

17 MR. BAUMANN: Your card was otherwise up. Were
18 there other things that you wanted to point out?

19 MS. ZIETSMAN: Yes, the only other thing I really
20 just wanted to point out was as I think I just mentioned,
21 we do have a project that is ongoing with respect to [ISA]
22 600. Obviously, ISA 600 is a different standard than what

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1 is in the PCAOB standards. It is a standard that has a
2 lot of issues, which is what has led the IAASB to put it
3 back on its agenda. But I think the one thing that we did
4 hear in the response to our feedback, and I think actually
5 it was mentioned in the presentation the fact that firms
6 have both methodologies around [ISA] 600 and there was a
7 recognition, I think broadly across our stakeholders, that
8 [ISA] 600 has been an important standard in improving the
9 quality of the multi-location audits. So it has been
10 helpful.

11 So, notwithstanding that there are issues and
12 challenges, it is a good standard and I think we got told
13 don't throw it away.

14 But at the same time, the other project that is
15 relevant is we have a project that is focused on ISA 220,
16 which is our standard that deals with quality control at
17 the engagement level. And really what we are trying to
18 do with that one is to take the kind of principles of
19 quality management and drive that into that standard and
20 I think, actually, the work that the PCAOB has done in
21 respect to the way you have looked at this issue has been
22 very helpful to us in terms of looking at well, how do you

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1 build a model that really drives the level of involvement
2 that is necessary in looking at the supervision model and
3 thinking about how it might work in different
4 circumstances.

5 So, I think a lot of the issues that we are dealing
6 with are very aligned with the issues that you have just
7 been talking about now. So, things like reliance on
8 networks. You know I think the other thing we are starting
9 to think about also is the situations where you have what,
10 at least at the IAASB, we have called audit delivery
11 models, where you have different types of engagement team
12 structures and involvement of centers of excellence that
13 may be on-shored, maybe off-shored but where you have
14 resources sitting in different locations.

15 And then the other situation, Marty, that you
16 mentioned yesterday about when the partner is not located
17 where the work is being performed and that has been pointed
18 out as a big gap in our standards as well.

19 So, I think between our two standards there -- well,
20 I think we are dealing with the same issues. So I think
21 the feedback that you have received is very informative
22 to us and, likewise, I think the feedback on our ATC is

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1 very informative too to the two projects. So, I think
2 there is a lot of scope for us to think about how to solve
3 these issues together. Thank you.

4 MR. ANDRIYENKO: Thank you, Megan. Tom Selling.

5 MR. SELLING: Thanks. I am going to start by
6 stating a couple of things which may be obvious to people
7 but I think they lead to what my recommendations are.

8 It seems to me that the premise of the standard
9 is to be able to reasonably accommodate issuers that wish
10 to avoid the cost of engaging a single auditor in
11 circumstances where the costs of doing so are unreasonably
12 high or even prohibitive.

13 Accordingly, the PCAOB is proposing new and
14 untested requirements to compensate for the added risk of
15 a single auditor not performing the entire audit, which
16 recent experience has indicated is a serious risk.

17 I expect that the PCAOB's original proposals were
18 motivated by inspection results and enforcement actions.
19 So, it is difficult to predict whether the additional
20 procedures you are proposing will be cost-effective.

21 And as I said, so far, everything I have said really
22 so far is obvious but these are my suggestions. In

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1 consideration of these observations, I would like to
2 suggest that the PCAOB consider an approach to rulemaking
3 that keeps its options open. For example, where the
4 comments you summarized suggest that rules are burdensome,
5 to give the commenters, initially, the benefit of the doubt
6 until post-implementation review and new experience from
7 inspections and enforcement provide information as to how
8 any new rules are working.

9 In that same spirit, perhaps the PCAOB should at
10 least consider making the proposal scalable to provide
11 extra accommodations for smaller companies.

12 On the other hand, I think that the determination
13 of who should be the lead auditor should be determined in
14 a rigid, rigorous way at all times with not a lot of room
15 for discretion by the auditor group. I think that is
16 qualitatively a different aspect of the proposal and
17 should be treated differently from a policymaking view.

18 MR. ANDRIYENKO: Thank you, Tom. We are making
19 notes of your suggestions. And of course, as I said, there
20 were many comments we received in different areas and we
21 are considering them now. I appreciate it.

22 MR. SELLING: You don't have to make notes, I have

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1 it written down word for word.

2 MR. ANDRIYENKO: And we will have a transcript,
3 yes. Thank you.

4 Mike Santay.

5 MR. SANTAY: Thanks, Dima and thanks to your group
6 for all your hard work in this area.

7 Two things. One, I just wanted to mention on the
8 divided responsibility, I know we talked about that at the
9 last SAG, and after the meeting, Jeanette Franzel, who I
10 don't think is here, reminded me that the GAO is one of
11 the largest proponents of maintaining divided
12 responsibility as an option in the U.S. because it is
13 important for their audits. And as you know, they use U.S.
14 auditing standards, board-set standards for GAO audits.
15 So, it was important to them at the time to maintain that
16 because of how government audits are performed. So, I
17 just thought I would share that.

18 And secondly, again thanks for doing the project.
19 I think Megan said a lot of what I was thinking about here.
20 You know, setting standards for the private companies in
21 the U.S., we look to converge with the IASSB. We did, the
22 Board did a significant convergence project a few years'

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1 back. So, our main focus is that. But we also are looking
2 to minimize differences with the PCAOB. We have an active
3 group of the Board that looks at PCAOB standards-setting,
4 monitors it, and where standards are finalized that we
5 believe would be a good enhancement for private company
6 audits, we make those changes. So, we are trying to
7 balance both. So, I think it is important.

8 And I think, Megan, you said the issues, there are
9 a lot of common issues here. And I think there some common
10 objectives, too. And really, it is about managing the
11 risks of these sometimes very complicated
12 multi-jurisdictional location audits. So you know,
13 getting the risk assessment right, getting the response
14 right, if there is other auditors involved, getting the
15 supervision right, some of those common themes are
16 resident in both projects.

17 So, I am grateful that there is going to be
18 continued informing between the two projects because I
19 think, especially from a U.S. perspective, with our
20 experience with divided responsibility and other things,
21 I think there are some good things in both projects. And
22 sometimes I think you mentioned the issues, the [ISA] 600

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1 standard as it is now, it is a bit of a forest and the trees.
2 And many of the issues have been more about how do I comply
3 with the standard, as opposed to how do I do a good quality
4 audit. I know it is an inspection focus of Helen and her
5 group. So, I think that will also probably help inform
6 your project as you go along.

7 But anyway, that is my observation.

8 MR. ANDRIYENKO: We are a little overtime. I
9 think we will allow for one more comment. Phil
10 Santarelli.

11 MR. SANTARELLI: Thank you. And Mike, that was a
12 good lead-in. I have a comment and a question.

13 I was actually involved in the AU-C 600 Task Force
14 when ASB was writing that standard. And one of the things
15 that struck me, I know I have said it before, I am repeating
16 myself, but it was my perception at the time that the
17 demands that were going to be placed on what was referred
18 to as component auditors were much different than the
19 current status of AU 543. And I recommend at least
20 thinking about ways to get those other auditors that are
21 doing a significant portion of the audit and, thus, in
22 scope for PCAOB registration and rules, to consider some

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1 standard-setting related to how they should relate, how
2 they should react to the principal auditor.

3 And then for Megan, I don't want to put you on the
4 spot. I know you did a post-issuance review on ISA 600
5 and you mentioned some issues have come up. Can you share
6 them with the SAG? It might be beneficial, if you can,
7 on what some of those issues were.

8 MS. ZIETSMAN: So, I probably won't get all of the
9 list of all of the issues. But I think one of the issues
10 that did come up was the challenges with respect to equity
11 method investments where you don't have the same -- where
12 the management and the auditor has the same kind of access.
13 So, that was one of the challenges.

14 I think there is challenges around component
15 materiality and how you approach that and how you set that
16 for different type of components. So, that is a
17 challenge.

18 There is challenges around the communications
19 between group auditors and component teams, and really
20 having that proper feedback loop.

21 I'm just trying to think. Challenges around risk
22 assessment and really making sure that risks at the group

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1 level are driven down to the component and how you make
2 sure, as a group engagement partner, that they have been
3 appropriately responded to.

4 Challenges around different type of groups, giving
5 rise to different types of challenges, when you start
6 dividing them up into components and think about scoping
7 your work at the different levels of components.

8 So, you know I think like Mike said, I think a lot
9 of the issues are some of the same kinds of issues that
10 the PCAOB is dealing with. And you said it really well,
11 Mike, the fact that the objectives of these are the same.
12 The objectives are to really make sure that we have
13 standards that drive quality work of these types of
14 engagements, which really are very, very complicated.
15 And I think we are also in a world where they are going
16 to continue to evolve, as we look at the different types
17 of technology trends, the different types of ways that
18 entities are structuring themselves.

19 Actually, sorry, that was one other thing I
20 remember was the evolving use of shared service centers
21 by companies, as well as by auditors. And that really
22 dealt with anyone's standards and how do you deal with

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1 those kinds of situations.

2 MR. BAUMANN: Dima and team, thank you very much
3 for your comments. You did an excellent job summarizing
4 what we heard, both pro and good questions that commenters
5 raised as part of the proposal.

6 And thank you, SAG members, for the good input you
7 have given us both today and when we discussed the proposal
8 before.

9 This is a really important area. I think, as we
10 have all mentioned, we are talking about the largest audit
11 that have the lead auditor who manages that global audit
12 around the world and ensures the high quality audit, not
13 only at headquarters, but at those far remote locations
14 where there could be material operations.

15 So, we will continue to work hard on this and
16 explore next steps and look together what the IAASB is
17 doing and learn from that as well.

18

NOTICE: This is an unofficial transcript of the portion of the Public Company Accounting Oversight Board's Standing Advisory Group meeting on May 24, 2017, that relates to *Proposed Amendments Relating To The Supervision of Audits Involving Other Auditors And Proposed Auditing Standard—Dividing Responsibility for the Audit With Another Accounting Firm*. The other topics discussed during the May 24-25, 2017, meeting are not included in this transcript excerpt. The Public Company Accounting Oversight Board does not certify the accuracy of this unofficial transcript, which may contain typographical or other errors or omissions. An archive of the webcast of the entire meeting can be found on the Public Company Accounting Oversight Board's website at: <https://pcaobus.org/News/Events/Pages/SAG-meeting-May-2017.aspx>.

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

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STANDING ADVISORY GROUP

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MEETING

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WEDNESDAY
MAY 24, 2017

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The Advisory Group met in Ballroom A, Washington Plaza Hotel, located at 10 Thomas Circle, Northwest, Washington, D.C., at 8:30 a.m., James R. Doty, Chairman, presiding.

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8 MS. MURRALL: Thank you, Marty. And if it's

9 okay, I would just like to go back to the standard

10 setting agenda and some of the points that you raised.

11 I very much appreciate the work that the PCAOB

12 has done to increase the transparency in the audit

13 reporting model and then in the audit engagement partner.

14 I'm here representing institutional investors.

15 They invest internationally, and we very much welcome

16 this harmonization internationally in transparency.

17 However, I do still remain concerned, and I've

18 expressed it before, about one of the requirements in the

19 supervision of auditors in that it appears to me that

20 you're still retaining this divided responsibility for

21 the audit in that my understanding is that is not

22 something that is currently done internationally. It's

1 certainly not done in the London market, which is an
2 international market. Companies list there that are
3 global.

4 But ultimately, the lead auditor has to take
5 responsibility for that audit. And if so, they have to
6 do additional procedures if they're not satisfied with
7 the work of other auditors, et cetera, et cetera.

8 And I'm concerned that if you have divided
9 responsibility, it could be perceived as a qualification
10 or limitation of scope in some way. And I just wondered
11 if you could expand on that.

12 MR. BAUMANN: Thanks, Liz. Good comment. There
13 were some commenters on the proposal on supervision of
14 global audits and other auditors who brought up that
15 point besides you.

16 And I didn't list that as one of the major
17 comments. And one of the reasons I didn't is I think the
18 number of audits with divided responsibility, Keith, is
19 in the neighborhood of maybe 50?

20 MR. WILSON: Yes, that's about right.

21 MR. BAUMANN: So about 50 audits where there is
22 divided responsibility. It's a small item, but I take

1 your point. And we are reconsidering that issue with the
2 Board as part of our re-deliberations.

3 I can't say how we'll come out on it. I will say
4 I believe the Auditing Standards Board of the U.S.,
5 contrary to the -- it normally follows the IAASB. The
6 Auditing Standards Board establishes practices for non-
7 public companies, and Mike Santay is sitting somewhere
8 around here.

9 I think, although they largely follow the ISA for
10 group audit area, they may have retained a divided
11 responsibility in the United States. Is that fair, Mike?

12 MR. SANTAY: Yes, that's right, Marty. And I
13 think we did talk a little bit about, you know, some of
14 the folks that use our standards. For example, the
15 government auditors that really kind of need that
16 accommodation because of the different structures for
17 government entities.

18 So that was one of the key points, I think, at
19 the time of the group audits where we did converge, but
20 we did differ on that one.

21 MR. BAUMANN: Good question. A good area for us
22 to continue to reconsider as we deliberate. So thank you

1 for that point. Chuck Senatore.

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

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

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STANDING ADVISORY GROUP

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MEETING

+ + + + +

THURSDAY
NOVEMBER 30, 2017

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

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1 MR. BAUMANN: ...

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

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

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

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

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

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

24 As you know, in 2016 the PCAOB proposed a number of amendments

1 to its auditing standards that govern planning and supervision of audits that
2 involve other firms and accountants outside the accounting firm that issues the
3 auditor's report on the company's financial statements. The amendments are
4 intended to increase the involvement by the lead auditor in the work of other
5 auditors. Enhance the ability of the lead auditor to prevent or detect deficiencies
6 in the work of other auditors. And also to facilitate improvements in the quality of
7 the work of other auditors.

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

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

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

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

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

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

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

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

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

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

23 Now the importance criterion. So when determining whether a firm
24 may serve as a lead auditor, the proposal required considering the risk of material

1 misstatement associated with the portion of the audit that the lead auditor audits.

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

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

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

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

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

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

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

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

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

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

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

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

24 Now with respect to the other auditor's knowledge, skill, and ability, the

1 proposal, the original proposal would require the lead auditor to understand the
2 qualifications of engagement team members who assist the engagement partner
3 in planning and supervising the audit.

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

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

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

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

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

24 And even if the other auditor shared this information with the lead

1 auditor, how the engagement partners at the lead auditor would lack expertise in
2 interpreting such information and making the evaluations.

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

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

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

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

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

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

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

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

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

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

23 The SRC also further clarifies how the risk-based supervisory
24 approach would apply to the lead auditor's request for the documentation, and

1 also review of the other auditor's work.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

1 frameworks.

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

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

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

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

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

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

20 MR. BAUMANN: Liz Murrall?

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

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

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

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

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

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

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

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

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

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

24 You know, it's owned by a variety of parties. But yet it's material to

1 their financial statements. And the equity investment is audited by another firm.

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

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

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

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

15 MR. ANDRIYENKO: Oh, fewer than 50.

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

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

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

24 But, we recognize your point and it's -- it is a careful one for us to think

1 about. And we understand your concern there.

2 Jeanette Franzel?

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

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

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

10 But, we do not have the numbers.

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

14 MR. ANDRIYENKO: Hm-mm.

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

17 ...

18 David Kane?

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

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

24 Right? Do you say it's 50 percent? Do you say, you know, based

1 upon this important characteristic or criterion which requires some judgement?

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

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

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

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

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

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

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

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

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

1 Wendy Stevens?

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

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

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

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

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

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

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

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

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

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

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

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

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

8 MR. BAUMANN: Thanks for those comments.

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

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

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

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

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

19 MR. BAUMANN: In those relatively few cases.

**Planning and Supervision of Audits Involving
Other Auditors
and
Dividing Responsibility for the Audit with
Another Accounting Firm**

PCAOB Release No. 2022-002
June 21, 2022

PCAOB Rulemaking
Docket Matter No. 042

Summary: The Public Company Accounting Oversight Board (“PCAOB” or the “Board”) is adopting amendments to its auditing standards to strengthen the requirements and responsibilities that apply to auditors who plan and perform audits that involve other accounting firms and individual accountants. The amendments are designed to improve the quality of audits in these circumstances by increasing the lead auditor’s involvement in and evaluation of the work of other auditors, and to align the applicable requirements with the PCAOB’s risk-based supervisory standards.

Board

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Amendments: The Board is adopting amendments to its standards, interpretations, rules, and forms that:

- (1) **Revise:**
- AS 1015, *Due Professional Care in the Performance of Work*;
 - AS 1105, *Audit Evidence*;
 - AS 1201, *Supervision of the Audit Engagement*;
 - AS 1215, *Audit Documentation*;
 - AS 1220, *Engagement Quality Review*; and
 - AS 2101, *Audit Planning*;

- (2) Rescind AS 1205, *Part of the Audit Performed by Other Independent Auditors*, and AI 10, *Part of the Audit Performed by Other Independent Auditors: Auditing Interpretations of AS 1205*;
- (3) Adopt AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*; and
- (4) Make additional conforming amendments.

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I. EXECUTIVE SUMMARY

We are amending our auditing standards to strengthen requirements for planning and supervising audits involving accounting firms and individual accountants (collectively, “other auditors”) outside the accounting firm that issues the auditor’s report (the “lead auditor”). In these audits, the lead auditor issues the audit report on the company’s consolidated financial statements, but other auditors often perform important work on the audit. The roles of other auditors have increased as companies’ global operations have grown. In addition, we are adopting a new auditing standard that will apply when the lead auditor divides responsibility for an audit with another accounting firm (“referred-to auditor”).

Working with other auditors and referred-to 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 their work and can reduce audit quality. 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 audit report.

This rulemaking is intended to increase and improve the lead auditor’s involvement in and evaluation of the other auditors’ work. We believe that the heightened attention to other auditors’ work will improve communication among auditors and the lead auditor’s ability to prevent or detect deficiencies in that work, and thus enhance the quality of audits involving other auditors and promote investor protection.

The amendments to the Board’s auditing standards are intended to improve PCAOB standards principally by (i) applying a risk-based supervisory approach to the lead auditor’s oversight of other auditors and (ii) requiring that the lead auditor perform certain procedures when planning and supervising an audit that involves other auditors. The amendments take into account recent practice developments in the lead auditor’s oversight of other auditors’ work, including the greater use of communication technology. In brief, the amendments:

- Require that the engagement partner determine whether his or her firm’s participation in the audit is sufficient for the firm to carry out the responsibilities of a lead auditor and report as such. The amendments also provide considerations for the engagement partner to use in making this determination and require that the audit’s engagement quality reviewer review the determination.
- Require that the lead auditor, when determining the engagement’s compliance with independence and ethics requirements, understand the other auditors’ knowledge of those requirements and experience in applying them. The amendments also require that the lead auditor obtain and review written affirmations regarding the other auditors’ policies and procedures related to those requirements and regarding compliance with the requirements, and a description of certain auditor-client

relationships related to independence. In addition, the amendments require the sharing of information about changes in circumstances and the updating of affirmations and descriptions in light of those changes.

- Require that the lead auditor understand the knowledge, skill, and ability of other auditors' engagement team members who assist the lead auditor with planning and supervision, and obtain a written affirmation from other auditors that their engagement team members possess the knowledge, skill, and ability to perform assigned tasks.
- Require that the lead auditor supervise other auditors under the Board's standard on audit supervision and inform other auditors about the scope of their work, identified risks of material misstatement, and certain other key matters. The amendments also require that the lead auditor and other auditors communicate about the audit procedures to be performed, and any changes needed to the procedures. In addition, the amendments require the lead auditor to obtain and review written affirmations from other auditors about their performance of work in accordance with the lead auditor's instructions, and to direct other auditors to provide certain documentation about their work.
- Provide that, in multi-tiered audits, a first other auditor may assist the lead auditor in performing certain required procedures with respect to second other auditors.

This rulemaking rescinds an interim standard but carries forward and strengthens some of its requirements in a new standard that applies to those infrequent situations where the lead auditor divides responsibility for a portion of the audit with another audit firm and therefore does not supervise the work performed by that firm. In these situations, the lead auditor refers in the audit report to the work of that auditor (i.e., a referred-to auditor). This new standard requires that in these situations the lead auditor determine that audit procedures were performed regarding the consolidation or combination of financial statements of the business units audited by the referred-to auditor into the company's financial statements. The standard also requires that the lead auditor obtain the referred-to auditor's written representation that it is independent and duly licensed to practice, and that the lead auditor disclose in the audit report the magnitude of the portion of the financial statements and, if applicable, internal controls audited by the referred-to auditor.

We are adopting the amendments and new standard after three rounds of public comment. Commenters generally expressed support for the rulemaking's objective of improving the quality of audits involving other auditors and referred-to auditors. They also suggested ways to revise or clarify the proposed amendments and standard. We have taken into account these comments, as well as observations of the Board and its staff through PCAOB oversight activities (including audit inspections and enforcement cases).

This release includes three appendices that set forth the amendments we are adopting and one appendix that discusses the amendments in more detail.

- Appendix 1 sets forth the amendments to certain PCAOB auditing standards that increase and improve lead auditors' involvement in and evaluation of other auditors' work.
- Appendix 2 presents the new auditing standard regarding divided-responsibility audits.
- Appendix 3 includes conforming amendments to other PCAOB auditing standards, auditing interpretations, attestation standards, rules, and a form.
- Appendix 4 discusses the comments and amendments in more detail.

The amendments and new standard apply to all audits conducted under PCAOB standards. Subject to approval by the Securities and Exchange Commission ("SEC" or "Commission"), the amendments and new standard will take effect for audits for fiscal years ending on or after December 15, 2024.

II. BACKGROUND

This rulemaking addresses the responsibilities of the lead auditor (i.e., the audit firm that issues the auditor's report) in planning and supervising an audit that involves the work of other auditors. In formulating the approach, we sought public comment several times. In April 2016, we issued a proposal ("2016 Proposal") to amend our auditing standards and issue a new standard, to strengthen the requirements for lead auditors in audits that involve other auditors and referred-to auditors.¹ In September 2017, after considering public comments on the 2016 Proposal, we issued a supplemental request for comment ("2017 SRC") on certain targeted revisions to the proposed amendments.² In September 2021, after considering the public comments on the prior releases, we issued a second supplemental request for comment ("2021 SRC") to seek additional public comment on certain revisions to the amendments and other matters.³

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 *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 (Sept. 28, 2021).

Commenters on the 2016 Proposal, 2017 SRC, and 2021 SRC (collectively, the “proposing releases”) generally expressed support for the rulemaking’s objective of improving the quality of audits involving other auditors and referred-to auditors. They also suggested ways to revise or clarify the proposed amendments and standard. We have considered all of the comments and are adopting the amendments and standard (collectively “amendments” or “final amendments”) for the reasons discussed below and in Appendix 4 of this release.

A. Rulemaking History

In the 2016 Proposal, we proposed to amend PCAOB auditing standards to strengthen existing requirements and impose a more uniform approach to the lead auditor’s supervision of other auditors.⁴ 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 a portion of the audit with another accounting firm and refers to the referred-to auditor’s report in the lead auditor’s report. We received 23 comment letters on the 2016 Proposal.⁵ Commenters generally expressed support for the rulemaking’s objective of improving the quality of audits involving other auditors and referred-to auditors. Some expressed concerns or requested clarification about certain proposed requirements.

In response to the input from commenters, we issued a supplemental request for comment on the 2016 Proposal in September 2017.⁶ The 2017 SRC discussed significant comments received and presented revisions to the proposed amendments while leaving the overall proposed approach to the supervision of other auditors intact. We received 22 comment letters on the 2017 SRC.⁷ 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.

After consideration of the comments on the 2017 SRC and further analysis of issues raised by commenters and developments in this area, we issued a second supplemental request for comment in September 2021. The proposed revisions in the 2021 SRC were 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. We received 19 comment letters on the 2021 SRC. Commenters continued to

⁴ See 2016 Proposal at Section II.

⁵ See 2017 SRC at 6-7 (discussing comment letters received on the 2016 Proposal).

⁶ 2017 SRC.

⁷ See 2021 SRC at 7 (discussing comment letters received on the 2017 SRC).

generally express support for the project's objectives, and also suggested some changes to, or requested clarification or guidance on, certain proposed requirements. We have considered the comments on the 2021 SRC, as well as on the previous proposing releases, in developing the final amendments.⁸ We have also considered the observations of the Board and its staff from PCAOB oversight activities.

B. Overview of Existing Requirements

This section discusses key provisions of existing PCAOB auditing standards that address lead auditor responsibilities involving the work of other auditors or referred-to auditors that participate in an audit. Depending on the circumstances of an audit involving other auditors, one of two standards applies, as described below.

In 2003, the Board adopted the standard known today as AS 1205, *Part of the Audit Performed by Other Independent Auditors* (at that time, AU sec. 543), when it adopted the auditing profession's standards then in existence.⁹ AS 1205 imposes requirements on a lead auditor (or "principal auditor," in the terminology of AS 1205) that uses the work and reports of other independent auditors that have audited the financial statements of one or more subsidiaries, divisions, branches, components, or investments included in the financial statements audited by the lead auditor. These requirements relate to situations in which the lead auditor uses the work and reports of other auditors or referred-to auditors by (i) assuming responsibility for the other auditors' work or (ii) dividing responsibility for the audit with referred-to auditors and referring to their work and reports in the lead auditor's audit report.¹⁰ Those "divided-responsibility" situations, as discussed below, are relatively uncommon.

⁸ The comment letters received on the 2016 Proposal, 2017 SRC, and 2021 SRC are available in the docket for this rulemaking on the PCAOB's website (<https://pcaobus.org/Rulemaking/Pages/Docket042Comments.aspx>).

⁹ In 1963, the American Institute of Certified Public Accountants ("AICPA") issued a codification of auditing standards that included several paragraphs on using the work of other auditors or referred-to auditors. In 1971, the AICPA issued Statement on Auditing Procedure No. 45, *Using the Work and Reports of Other Auditors*, and in 1972 it codified the standard in section 543 of the Statement on Auditing Standards No. 1 (AU sec. 543). In 2003, the PCAOB adopted the auditing profession's standards in existence at that time, including AU sec. 543. See *Establishment of Interim Professional Auditing Standards*, PCAOB Release No. 2003-006 (Apr. 18, 2003). In 2015, the PCAOB reorganized its auditing standards using a topical structure and a single, integrated numbering system. See *Reorganization of PCAOB Auditing Standards and Related Amendments to PCAOB Standards and Rules*, PCAOB Release No. 2015-002 (Mar. 31, 2015). As part of that rulemaking, AU sec. 543 was reorganized as AS 1205. The reorganization did not impose additional requirements on auditors or substantively change the requirements of that standard.

¹⁰ For example, the lead auditor may divide responsibility for a portion of the audit with another firm if it is impracticable for the lead auditor to review the other firm's work. See AS 1205.06.

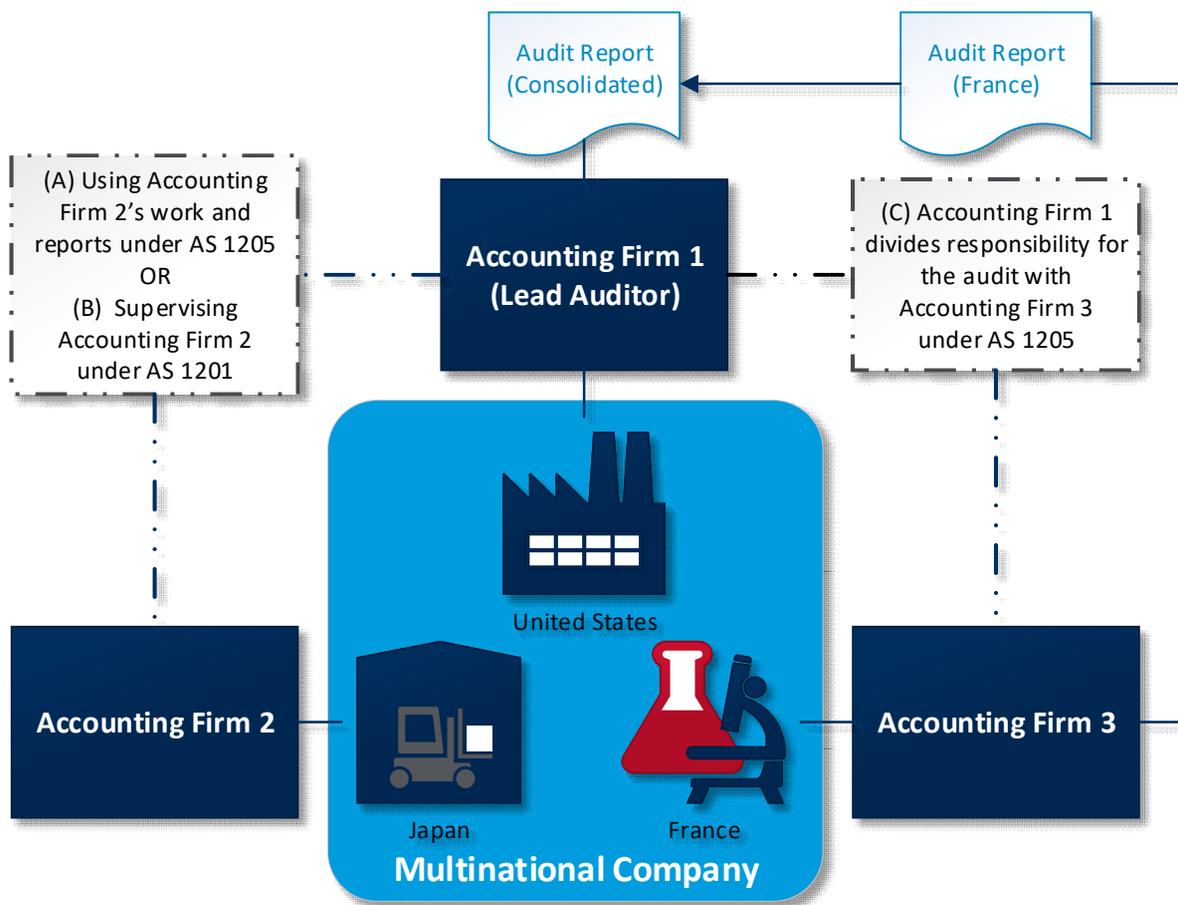
In 2010, the Board adopted AS 1201, *Supervision of the Audit Engagement* (at that time, Auditing Standard No. 10), when it adopted eight new auditing standards that set forth the auditor's responsibilities for assessing and responding to risk in an audit.¹¹ AS 1201 governs the supervision of the audit engagement, including supervising the work of engagement team members outside the engagement partner's firm. Under existing PCAOB standards, the lead auditor supervises the work of another auditor under AS 1201 in situations not covered by AS 1205.¹²

Figure 1 illustrates an example of a U.S.-based audit that involves other accounting firms, and the PCAOB auditing standards that apply to the audit. In the example, Accounting Firm 1 is the lead auditor, and it involves Accounting Firm 2 by either (A) assuming responsibility for the work and reports of Accounting Firm 2 in accordance with AS 1205, or (B) supervising the work of Accounting Firm 2 in accordance with AS 1201. The lead auditor (C) divides responsibility for part of the audit with Accounting Firm 3 in accordance with AS 1205 and refers to Accounting Firm 3 in the lead auditor's audit report on the consolidated financial statements.

¹¹ *Auditing Standards Related to the Auditor's Assessment of and Response to Risk and Related Amendments to PCAOB Standards*, PCAOB Release No. 2010-004 (Aug. 5, 2010). Among other things, these risk assessment standards established risk-based requirements for determining the necessary audit work in multi-location audit engagements.

¹² See second note to AS 1205.01.

Figure 1. Example of an Audit Involving Other Accounting Firms



The following discusses AS 1205 and AS 1201 in more detail:

- (A) *Using the work and reports of other auditors under AS 1205.* If an auditor uses, and assumes responsibility for, the work and reports of other auditors that audited the financial statements of one or more subsidiaries, divisions, branches, components, or investments included in the financial statements presented, AS 1205 includes the following requirements:¹³

¹³ In addition, in situations governed by AS 1205, the lead auditor is required by the Board’s standard on planning, AS 2101, *Audit Planning*, to perform procedures to determine the locations or business units at which audit procedures should be performed. See AS 2101.11–.13. This also applies to situations in which the auditor divides responsibility with another accounting firm. See AS 2101.14.

- When significant parts of the audit are performed by other auditors (from the same network of firms as the lead auditor or outside the network), the auditor is required to decide whether its own participation in the audit is sufficient to enable it to serve as the lead auditor (or, in the language of AS 1205, the “principal auditor”) and to report as lead auditor on the company’s consolidated financial statements.¹⁴
- Whether or not the lead auditor decides to make reference to the audit of the other auditor, the lead auditor is required to make inquiries about the professional reputation and independence of the other auditor.¹⁵ In addition, the lead auditor is required to adopt appropriate measures to assure the coordination of its activities with those of the other auditor in order to achieve a proper review of the matters affecting the consolidating or combining of accounts in the financial statements. Those measures may include procedures to ascertain through communication with the other auditor:
 - That the other auditor is aware that the financial statements of the component which it is to audit are to be included in the financial statements on which the lead auditor will report, and that the other auditor’s report will be relied upon (and, where applicable, referred to) by the lead auditor;
 - That the other auditor is familiar with the accounting principles generally accepted in the United States and with the standards of the PCAOB, and will conduct its audit and issue its report in accordance with those standards;
 - That the other auditor has knowledge of the SEC’s financial reporting requirements; and
 - That a review will be made of matters affecting elimination of intercompany transactions and accounts and, if appropriate, the uniformity of accounting practices among the components included in the financial statements.¹⁶
- The lead auditor must obtain, review, and retain certain information from the other auditor before issuing the report, including an engagement

¹⁴ See AS 1205.02.

¹⁵ AS 1205.10.

¹⁶ AS 1205.10.c.

completion document, a list of significant risks, the other auditor's responses to those risks, the results of the other auditor's related procedures, and significant deficiencies and material weaknesses in internal control over financial reporting.¹⁷

- The lead auditor also should¹⁸ consider performing one or more of the following procedures: visiting the other auditor, reviewing the audit programs of the other auditor (and, in some cases, issuing instructions to the other auditor), and reviewing additional audit documentation of significant findings or issues in the engagement completion document.¹⁹

(B) *Including the other auditors in the engagement team and supervising their work under AS 1201.* This standard governs the auditor's supervision of an audit engagement, including the work of other auditors who are members of the same engagement team, wherever they are located. AS 1201, as it relates to the supervision of other auditors on the engagement team, includes the following requirements:

- The engagement partner is responsible for the engagement and its performance.²⁰ The engagement partner may seek assistance from appropriate engagement team members in fulfilling his or her responsibilities for the engagement and its performance.²¹ Engagement team members can be from the engagement partner's firm or outside the firm.
- The engagement partner and others who assist the engagement partner in supervising the work of other engagement team members are required to:
 - Inform the engagement team members of their responsibilities for the work they are to perform, including the objective of the procedures they are to perform, the nature, timing, and extent of those procedures, and matters that could affect those procedures;

¹⁷ AS 1205.12.

¹⁸ The word "should," as used in the auditing and related professional practice standards, indicates responsibilities that are presumptively mandatory. See Paragraph (a)(2) of PCAOB Rule 3101, *Certain Terms Used in Auditing and Related Professional Practice Standards*. Rule 3101 also defines other terms, such as "must" and "may," that describe the degree of responsibility that the standards impose on auditors.

¹⁹ AS 1205.12.

²⁰ AS 1201.03.

²¹ AS 1201.04.

- Direct the engagement team members to inform the engagement partner or supervisors of significant accounting and auditing issues arising during the audit; and
 - Review the work of engagement team members to evaluate whether the work was performed and documented, the objectives of the procedures were achieved, and the results of the work support the conclusions reached.²²
 - The engagement partner and others who assist the engagement partner in supervising the audit should determine the extent of supervision necessary for engagement team members to perform their work as directed and form appropriate conclusions. Under this standard, requirements for supervision are risk-based and scalable, and the necessary extent of supervision varies depending on, for example, the nature of the assigned work, the risks of material misstatement associated with that work, and the knowledge, skill, and ability of each individual involved.²³
- (C) *Dividing responsibility for the audit with another accounting firm.* AS 1205 also governs audits in which the lead auditor divides responsibility for the audit with another accounting firm that issues a separate auditor's report on the financial statements of one or more subsidiaries, divisions, branches, components, or investments included in the company's financial statements.²⁴ The requirements of AS 1205 that apply under these circumstances are more limited than the requirements that apply to the lead auditor's use of the work and reports of other auditors when the lead auditor assumes responsibility for the other auditor's work (discussed in item A above).²⁵ For example, AS 1205 does not require the lead auditor to obtain, review, and retain certain information from the accounting firm with which the lead auditor divides responsibility for the audit (which is required when the lead auditor assumes responsibility for another firm's work under AS 1205).²⁶ If the lead auditor refers in its report to the work of another firm, the lead auditor's report indicates the division of

²² AS 1201.05.

²³ AS 1201.06.

²⁴ For auditors' reports on non-issuer entities, where the principal accountant elects to place reliance on the work of the other accountant and makes reference to that effect in the auditor's report, SEC rules require that the other accounting firm's report be filed with the SEC. See Rule 2-05 of Regulation S-X, 17 C.F.R. § 210.2-05.

²⁵ AS 1205.06-.09.

²⁶ AS 1205.12.

responsibility and the magnitude of the portion of the financial statements audited by the other firm.²⁷

C. Existing Practice

This section describes the state of practice – including the evolution of audit practices and related inspection findings – that the Board and its staff have observed in past years through PCAOB oversight activities (including through observations from audit inspections and enforcement cases).

1. Evolution of Auditing Practice at Accounting Firms

Auditors around the world, even when they perform audit procedures that are required to comply with PCAOB standards, may be influenced by international and home country auditing standards. With respect to the use of other auditors, the standards of the International Auditing and Assurance Standards Board (“IAASB”) – specifically, International Standard on Auditing (“ISA”) 600²⁸ – establishes requirements for “group audits.”²⁹ ISA 600 was originally developed in the wake of several significant frauds that involved multinational groups of companies, audited by multiple accounting firms.³⁰ In December 2021, the IAASB approved amendments to ISA 600 in a project that was informed by, among other things, persistent deficiencies in group audits reported by the International Forum of Independent Audit Regulators (“IFIAR”).³¹

²⁷ AS 1205.07–.09.

²⁸ ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* (effective for audits of group financial statements for periods beginning on or after December 15, 2009); ISA 600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* (effective for audits of group financial statements for periods beginning on or after December 15, 2023). See also AU-C Section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* (standard adopted by the AICPA’s Auditing Standards Board (“ASB”)).

²⁹ Under ISA 600, group audits are audits of “group financial statements” consisting of at least two “components.” Group audits generally are performed by a “group engagement team” and one or more “component auditors” and may involve a single firm or multiple firms.

³⁰ See, e.g., *Koninklijke Ahold N.V. (Royal Ahold)*, A. Michiel Meurs, Cees van der Hoeven, Johannes Gerhardus Andrae, and Ture Roland Fahlin, SEC Accounting and Auditing Enforcement Release (“AAER”) No. 2124 (Oct. 13, 2004); *Lernout & Hauspie Speech Products*, SEC AAER No. 1729 (Mar. 4, 2003); *In re Parmalat Finanziaria, S.p.A.*, SEC AAER No. 2065 (July 28, 2004); see also Michael J. Jones, ed., *Creative Accounting, Fraud and International Accounting Scandals* (2011) (describing, in Part B, 58 high-profile accounting scandals across 12 countries, including the Royal Ahold and Parmalat cases).

³¹ See paragraph 7 of IAASB, *Invitation to Comment, Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits* (Dec. 2015); see also IFIAR, *2017*

Meanwhile, the PCAOB has observed through its oversight activities that, after the PCAOB and IAASB adopted their own standards on risk assessment, some audit firms, particularly some of the largest firms that work extensively with other auditors, revised their policies, procedures, and guidance (“methodologies”) for using other auditors. The PCAOB has also observed differences among firms’ methodologies, for example, in their approaches to determining whether the firm’s participation in an audit is sufficient for the firm to serve as lead auditor. Section IV.A.2 below provides additional analysis of audit firm methodologies.

The PCAOB has also noted through its oversight activities that some audit firms have applied advances in technology to various aspects of the audit, including the supervision of engagement team members and other communications.³² The PCAOB has taken these practice developments into account in formulating the amendments.

2. Observations from Audit Inspections and Enforcement Cases

This section discusses observations based on PCAOB audit inspections and PCAOB and SEC enforcement cases. PCAOB staff has inspected the work of auditors who use other auditors, such as by reviewing the scope of work performed by the other auditor, the planning and instructions provided to the other auditor, and the degree of supervision (including review) of the other auditor. The PCAOB has also inspected the work of other auditors, such as by conducting inspections abroad and reviewing work performed by non-U.S. auditors at the request of a U.S.-based lead auditor. In some cases, PCAOB staff inspected the work performed by both the lead auditor and other auditors on the same audit. In many cases, but not always, the lead auditor was a U.S. firm while the other auditor was located in another jurisdiction. In addition, in 2019 the PCAOB established a “target team” of staff who performed inspection procedures across inspected firms. The team focused on U.S.-based multi-location audits and on issuer audits at annually inspected firms in which the U.S. firm was not the lead auditor.³³

Survey of Inspection Findings (Mar. 8, 2018), at 10 (showing group audits among the inspection themes with frequent findings in 2014-2017); IAASB, *Work Plan for 2015–2016: Enhancing Audit Quality and Preparing for the Future* (Dec. 2014), at 7 (“Concern [with ISA 600] has been expressed about: [t]he extent of the group auditor’s involvement in the work of the component auditor ... ; [c]ommunication between the group auditor and the component auditor; [a]pplication of the concept of component materiality; [i]dentifying a component in complex situations; and [w]ork effort of the component auditor.”).

³² See PCAOB, *Spotlight: Data and Technology Research Project Update* (May 2020), at 4-5 (noting that some firms have applied technology and developed tools to “improve communications between the auditor and the company or among members of the engagement team (including other auditors), track information received during the audit, automate the documentation of procedures performed, and facilitate the efficiency of supervisory review.”).

³³ See PCAOB, *Spotlight: Staff Update and Preview of 2019 Inspection Observations* (Oct. 8, 2020).

i. Other Auditors

PCAOB inspections staff has observed significant audit deficiencies in the work performed by other auditors, including noncompliance with the lead auditor's instructions and failure to communicate significant accounting and auditing issues to the lead auditor. Deficiencies have also been identified in other auditors' compliance with PCAOB standards governing a variety of audit procedures.³⁴

These failures in audit performance occurred in critical audit areas that are frequently selected for inspection, including revenue, accounts receivable, internal control over financial reporting, and accounting estimates including fair value measurements. For example, in several instances, other auditors failed to perform sufficient procedures in auditing the revenue of a company's business unit, including with respect to evaluating the business unit's revenue recognition policy, testing the occurrence of revenue, and testing the operating effectiveness of the business unit's controls over revenue. In recent years, there have been some indications of decreasing inspection-observed deficiencies, as discussed below in Section IV.

The Board in its enforcement cases has made similar findings about failures in audit performance. In one case, the Board found that an other auditor failed to perform audit procedures and to exercise supervisory responsibilities in accordance with PCAOB standards.³⁵ In another case, an other auditor failed to exercise due professional care and failed to obtain sufficient audit evidence for the audit work on accounts receivable.³⁶ In a more recent case, other auditors failed to exercise due professional care, respond adequately to a known significant risk, and obtain sufficient appropriate audit evidence, and they misrepresented their work in communications with the lead auditor.³⁷

ii. Lead Auditor

Over the years, there have been numerous observations from inspections and from enforcement cases where 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. These failures occurred at large and small firms, domestic and international. Among the most egregious findings, lead auditors failed to perform an audit or participated very little in the audit, and instead issued an audit report on the basis of procedures performed by

³⁴ See, e.g., 2016 Proposal at 16-17.

³⁵ See *In the Matter of Akiyo Yoshida, CPA*, PCAOB Release No. 105-2014-024 (Dec. 17, 2014). Unless otherwise indicated, the enforcement cases discussed in this section were settled proceedings.

³⁶ See *In the Matter of Wander Rodrigues Teles*, PCAOB Release No. 105-2017-007 (Mar. 20, 2017).

³⁷ See *In the Matter of Ricardo Agustín García Chagoyán, José Ignacio Valle Aparicio, and Rubén Eduardo Guerrero Cervera*, PCAOB Release No. 105-2018-021 (Oct. 30, 2018).

other auditors.³⁸ In these audits, the auditor failed to appropriately determine that it could serve as the lead auditor when all or a substantial portion of the financial statements were audited by another auditor. In two SEC enforcement cases, one firm failed to perform any analysis,³⁹ and another firm failed to perform an adequate analysis,⁴⁰ under AS 1205 regarding the sufficiency of its participation to serve as lead auditor.

There also have been findings in which the lead auditor failed to assess, or adequately assess, the qualifications of other auditors' personnel who participated in the audit. For example, PCAOB oversight activities have revealed situations in which the other auditors' personnel lacked the necessary industry experience or knowledge of PCAOB standards and rules (including independence requirements), SEC rules, and the applicable financial reporting framework to perform the work requested by the lead auditor.⁴¹ Other examples identified through PCAOB and SEC oversight activities include audits in which: (i) the lead auditor failed to ascertain whether the other auditors, each of whom played a substantial role in the audit,⁴² were registered with the PCAOB;⁴³ (ii) the lead auditor failed to obtain, review, and retain the results of the other auditor's procedures relating to risks;⁴⁴ (iii) the lead auditor failed to instruct the other auditor to perform an audit in accordance with PCAOB standards;⁴⁵ (iv) the

³⁸ For findings in PCAOB enforcement cases, see, for example, *In the Matter of Michael T. Studer, CPA, P.C. and Michael T. Studer, CPA*, PCAOB Release No. 105-2012-007 (Sept. 7, 2012), and *In the Matter of Bentleys Brisbane Partnership and Robert John Forbes, CA*, PCAOB Release No. 105-2011-007 (Dec. 20, 2011). Some of the standards violated in the enforcement cases cited in this release were predecessor standards to current PCAOB standards. The descriptions of inspection findings in this release are based on certain accounting firm inspection reports (portions of which are available on the PCAOB's website) and on the PCAOB's experience with inspecting firms.

³⁹ See *BDO Canada LLP (f/k/a BDO Dunwoody LLP)*, SEC AAER No. 3926 (Mar. 13, 2018).

⁴⁰ See *KPMG Inc.*, SEC AAER No. 3927 (Mar. 13, 2018).

⁴¹ See, e.g., *In the Matter of Gregory & Associates, LLC, and Alan D. Gregory, CPA*, PCAOB Release No. 105-2019-018 (Aug. 21, 2019).

⁴² See PCAOB Rule 2100, *Registration Requirements for Public Accounting Firms* (providing that any firm that plays a substantial role in the preparation or furnishing of an audit report with respect to any issuer, broker, or dealer must be registered with the Board); see also PCAOB Rule 1001(p)(ii), *Definitions of Terms Employed in Rules* (defining the phrase "play a substantial role in the preparation or furnishing of an audit report").

⁴³ See, e.g., *BDO Canada LLP*, SEC AAER No. 3926; *KPMG Inc.*, SEC AAER No. 3927.

⁴⁴ See *In the Matter of Ron Freund, CPA*, PCAOB File No. 105-2009-007 (Jan. 26, 2015), at 1 (Board order summarily affirming hearing officer's finding of violation and imposition of sanction) (finding a violation of AU 543.12b, which was reorganized by the PCAOB in March 2015 as AS 1205.12b, and which required that "the principal auditor must obtain, and review and retain, ... [a] list of significant fraud risk factors, the auditor's response, and the results of the auditor's related procedures").

⁴⁵ See *BDO Canada LLP*, SEC AAER No. 3926.

lead auditor failed to supervise the other auditors or provide specific instructions to them, including detailed audit plans, appropriate modifications to audit plans based on identified risks, the audit objectives to be accomplished, or the need to maintain proper documentation;⁴⁶ (v) the lead auditor failed to adequately supervise the work of foreign audit staff in circumstances in which the engagement partner did not speak, read, or write the language used by the foreign staff;⁴⁷ and (vi) the lead auditor failed to adequately analyze whether it could serve as the principal auditor, relied on the work of an other auditor that was not registered with the PCAOB, and failed to determine whether the other auditor's work complied with PCAOB auditing standards.⁴⁸ In recent years, there have been indications of increased involvement by some firms in the supervision of other auditors, as discussed below in Section IV.

iii. Divided-Responsibility Audits

As noted above, audits in which the lead auditor divides responsibility with one or more other accounting firms are relatively uncommon.⁴⁹ For example, division of responsibility between auditors might occur for an equity method investment or a late-year acquisition of a company audited by another auditor.

3. Evolution of Inspection Findings

As noted above, some firms, particularly larger firms affiliated with global networks, have increased their supervision of other auditors in light of other standards. In recent years, some larger U.S. firms have made further changes to their audit methodologies, perhaps in response to deficiencies identified by PCAOB inspections, enforcement cases by regulators, and ongoing rulemaking developments. Specifically, some firms have encouraged a greater level of supervision by the lead auditor, such as frequent comprehensive communications with other auditors and review of other auditors' work papers in the areas of significant risk.

There have been some indications from PCAOB inspections that these firms' revisions to methodologies may have contributed to a decline in inspection-observed audit deficiencies at

⁴⁶ See, e.g., *Anderson Bradshaw PLLC, Russell Anderson, CPA, Sandra Chen, CPA, and William Denney, CPA*, SEC AAER No. 3856 (Jan. 26, 2017); *Sherb & Co., LLP, Steven J. Sherb, CPA, Christopher A. Valleau, CPA, Mark Mycio, CPA, and Steven N. Epstein, CPA*, SEC AAER No. 3512 (Nov. 6, 2013).

⁴⁷ See, e.g., *In the Matter of Acquavella, Chiarelli, Shuster, Berkower & Co., LLP*, PCAOB Release No. 105-2013-010 (Nov. 21, 2013); *In the Matter of David T. Svoboda, CPA*, PCAOB Release No. 105-2013-011 (Nov. 21, 2013).

⁴⁸ See *In the Matter of Morgan & Company LLP*, PCAOB Release No. 105-2021-002 (Mar. 30, 2021).

⁴⁹ 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 in 2021, 2020, 2019, and 2018 disclosed 36, 41, 37, and 42 divided-responsibility audits, respectively.

the firms' foreign affiliates with respect to work performed at the lead auditor's request.⁵⁰ In 2014, for example, PCAOB inspections staff observed a decrease in the number of significant audit deficiencies in work performed by other auditors.⁵¹ Since 2014, the rate of deficiencies has fluctuated but remained below the 2013 level. Thus, the changes to the methodologies of some firms appear to have contributed to some improvements in the quality of audits.

In 2019, some of the Board's inspections focused on certain topics in audits involving other auditors, including planning and risk assessment, determining the appropriateness of serving as lead auditor, and communications between the lead auditor and other auditors. The inspectors observed improved audit quality when the lead auditor and other auditors communicated regularly and consistently. They also observed areas for improvement, including the documentation of required procedures, reporting of certain audit participants, and compliance with independence requirements.⁵²

D. Reasons to Improve Auditing Standards

The increasing globalization of business, especially among large public companies, has led to expanded use of other auditors and increasingly significant roles for other auditors within the audit. When other auditors participate in an audit, it is important for investor protection that the engagement partner and, in turn, lead auditor assure that the audit is performed in accordance with PCAOB standards and that sufficient appropriate evidence is obtained through the combined work of the lead auditor and other auditors to support the lead auditor's opinion in the audit report on the company's consolidated financial statements. Among other things, this means that the lead auditor should be appropriately involved in the audit so that the work of all audit participants is properly planned and supervised, the results of the work are properly evaluated, and the lead auditor is in a position to conclude that the financial statements are presented fairly in all material respects. Lack of adequate lead auditor planning or supervision can result in deficient audits.

⁵⁰ For data regarding deficiencies in audits that involve other auditors, see Section IV.A.2.ii below.

⁵¹ See PCAOB, *Staff Inspection Brief: Information about 2017 Inspections*, Vol. 2017/3 (Aug. 2017), at 7. The observed decrease is in comparison to the rate of deficiencies in certain inspected work in 2011, 2012, and 2013, when inspections staff, in each year respectively, identified significant audit deficiencies in about 32, 38, and 42 percent of the inspected work performed for lead auditors by non-U.S. members of the six largest global networks. See *Audit Committee Dialogue*, PCAOB Release No. 2015-003 (May 7, 2015), at 9 (graph entitled "Deficiencies in Non-U.S. Referred Work"). Because issuer audit engagements and aspects of those engagements are selected for inspection based on a number of risk-related and other factors, the deficiencies included in inspections reports are not necessarily representative of the inspected firms' issuer audit engagement practice.

⁵² See PCAOB, *Spotlight: Staff Update and Preview of 2019 Inspection Observations* (Oct. 8, 2020), at 5-6.

As noted above, some firms have made changes to their audit methodologies regarding the use of other auditors. However, other firms that have not made significant improvements to their methodologies concerning the planning and supervision of audits involving other auditors may have greater risk of lower quality audits when they use other auditors.

Additionally, observations from PCAOB oversight activities indicate that further improvements are needed. PCAOB staff continues to identify deficiencies in the work of other auditors in critical audit areas, deficiencies that lead auditors had not identified or sufficiently addressed. In some cases, these deficiencies occurred even when lead auditors did not violate existing requirements related to the use of other auditors, for example, if the lead auditor performed the procedures described in AS 1205 but did not identify these deficiencies. Such findings indicate that investor protection could be improved by, among other things, increased involvement in, and evaluation of, the work of other auditors by the lead auditor.

1. Areas for Improvement

To enhance audit practice among all firms using other auditors, the Board identified the following areas for improvement in the current standards:

- *Applying a risk-based supervisory approach.* Applying a risk-based supervisory approach to the lead auditor's oversight of other auditors' work should result in more appropriate involvement by the lead auditor in audits involving other auditors. Unlike the Board's standards for determining the scope of multi-location audit engagements and general supervision of the audit, which require more audit attention to areas of greater risk, the existing standard for using the work of other auditors does not explicitly require the lead auditor to tailor its planning and oversight of other auditors for the associated risks. Applying a risk-based supervisory approach will direct the lead auditor's attention to the areas of greatest risk.
- *Providing additional specificity.* Providing additional specificity for the lead auditor's application of the principles-based supervisory requirements of PCAOB standards to the supervision of other auditors should help address the unique aspects of supervising other auditors. Additional specificity should also help the lead auditor assure that its participation in the audit is sufficient for it to carry out its responsibilities and issue an audit report based on sufficient appropriate evidence.
- *Taking into account recent changes in auditing practice.* Revising PCAOB auditing standards to take into account recent changes that some firms have implemented to make their auditing practices more rigorous for audits that involve other auditors should make those improved practices more uniform across all accounting firms and enable the PCAOB to enforce more rigorous provisions across all firms.

Because of the lead auditor's central role in an audit involving multiple firms, the amendments adopted by the Board seek to strengthen the existing requirements and impose a

more uniform approach to the lead auditor's oversight of other auditors' work. These improvements are intended to increase the lead auditor's involvement in and evaluation of the work of other auditors generally, improve communication among the lead auditor and other auditors, enhance the ability of the lead auditor to prevent or detect deficiencies in the work of other auditors, and thus facilitate improvements in the quality of audits involving other auditors and promote investor protection.

2. Comments on the Reasons for Standard Setting

A number of commenters on the proposing releases broadly expressed support for enhancing PCAOB standards for using the work of other auditors and referred-to auditors, or stated that the proposed rulemaking would lead to improvements in audit quality. Some of the same commenters and others supported the Board's objective of establishing requirements for overseeing other auditors' work that are risk-based and more closely aligned with the Board's risk assessment standards than the existing standards are. Some commenters supported updating PCAOB standards in light of, among other things, changes in the business environment, company structure, accounting firm and network structure, regulation, and financial reporting, and the increased prevalence of audits involving other auditors. Some other commenters supported providing a more uniform approach to the lead auditor's supervision of other auditors. However, in the view of one commenter, some of the root causes of poor audit performance are not obvious, they have specific effects that are hard to isolate, and not all can be remedied by auditors and the PCAOB.

Although commenters generally supported applying a risk-based approach to the lead auditor's oversight of other auditors' work, some commenters on the proposing releases expressed concerns about certain aspects of the amendments and their economic impact. Some recommended further improvements to the proposed amendments. In the view of some commenters, the amendments should include additional direction in certain areas, be more scalable and better aligned with the risk-based approach, and provide more latitude for the lead auditor to exercise professional judgment, e.g., in determining the nature, timing, and extent of supervisory activities. The Board's consideration of the comments received is discussed further in Appendix 4 and elsewhere in this release, including in the economic analysis in Section IV below.

In adopting the amendments, the Board has taken into account the comments received on the proposing releases. Based on information available to the Board – including the current regulatory baseline, observations from the Board's oversight activities, academic literature, and comments – the Board believes that investors will benefit from strengthened and clarified auditing standards in this area. While the Board does not expect that the revisions to the standards will (or ever could) entirely eliminate audit deficiencies in this area, the revisions will clarify the auditor's responsibilities, align the applicable requirements with the PCAOB's risk-based supervisory standards, and improve the quality of audits.

III. OVERVIEW OF FINAL RULES

The amendments the Board is adopting are intended to strengthen the existing requirements and impose a more uniform approach to the lead auditor's supervision of other auditors.⁵³ As discussed in more detail in Appendix 4 of this release, they are designed to increase the lead auditor's involvement in, and evaluation of, the work of other auditors, enhance the lead auditor's ability to prevent or detect deficiencies in the work of other auditors, and facilitate improvements in the quality of the work of other auditors. In addition, the Board is adopting a new auditing standard that will apply when the lead auditor divides responsibility for an audit with another accounting firm. The key aspects of the amendments and new standard include:

- Planning the audit. AS 2101, *Audit Planning*, as amended⁵⁴ will provide that:
 - In audits involving 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.⁵⁵ The amendments also describe considerations for making the sufficiency determination. (AS 2101.06A)
 - In audits involving referred-to auditors, the Board has established that participation of the engagement partner's firm is ordinarily not sufficient for it to serve as lead auditor if more than 50 percent of the assets or revenues are audited by referred-to auditors. (AS 2101.06A)
 - Another amended PCAOB standard, AS 1220, *Engagement Quality Review*, will expressly require that the engagement quality reviewer for the audit review the engagement partner's determination about the sufficiency of his or her firm's participation in the audit to serve as lead auditor. (AS 1220.10a)
 - In audits that involve work performed by other auditors regarding locations or business units, the lead auditor's involvement (through planning and performing audit procedures and supervising other auditors) should be commensurate with

⁵³ The amendments apply to audits of issuers, as defined in Section 2(a)(7) of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"), 15 U.S.C. § 7201(7), and also, as discussed in Section VI below, to audits of brokers and dealers, as defined in Sections 110(3) and (4) of Sarbanes-Oxley, 15 U.S.C. §§ 7220(3)–(4).

⁵⁴ The amendments to AS 2101 and AS 1201 appear in the main body of each standard and in Appendix A of AS 2101. As originally proposed, most of the amendments to these standards would have appeared in a new Appendix B of each standard. As adopted, the provisions that would have appeared in Appendix B are instead integrated in the main body of the standards. See 2021 SRC at 9.

⁵⁵ Under the amended standard, in an integrated audit of financial statements and internal control over financial reporting ("ICFR"), the lead auditor's participation in the audit of ICFR must also be sufficient to provide a basis for it to serve as the lead auditor of ICFR. (AS 2101.06C)

- the risks of material misstatement associated with those locations or business units. (AS 2101.06B)
- When determining the engagement’s compliance with independence and ethics requirements in audits involving other auditors, the lead auditor should:
 - Understand the other auditor’s knowledge of SEC independence requirements and PCAOB independence and ethics requirements (“independence and ethics requirements”), and experience in applying the requirements. (AS 2101.06Da)
 - Obtain and review written affirmations⁵⁶ regarding (1) the other auditor’s policies and procedures regarding independence and ethics requirements and, if there are none, a description of how it determines its compliance; (2) the other auditor’s compliance with independence and ethics requirements, which also describe the nature of any instances of non-compliance; and (3) a description of all relationships between the other auditor and the audit client or persons in financial reporting oversight roles that may reasonably be thought to bear on independence. (AS 2101.06Db)
 - Inform the other auditor of changes that affect determining compliance with independence and ethics requirements and are relevant to the other auditor’s affirmations and descriptions. (AS 2101.06Dc(1))
 - Request that the other auditor update its affirmations and descriptions to reflect any changes in circumstances. (AS 2101.06Dc(2))
 - If the other auditor would play a substantial role in the audit,⁵⁷ the lead auditor may use the other auditor only if the other auditor is registered with the PCAOB. (AS 2101.06G)
 - With respect to the other auditor’s knowledge, skill, and ability, the lead auditor should:
 - Understand the knowledge, skill, and ability of the other auditor’s engagement team members who assist the lead auditor with planning and supervision. (AS 2101.06Ha)

⁵⁶ The terms “obtain,” “retain,” “written,” or “in writing” do not mandate that documents related to the audit be paper-based. See paragraph .04 of AS 1215, *Audit Documentation* (audit documentation may be in the form of paper, electronic files, or other media).

⁵⁷ See PCAOB Rule 1001(p)(ii) (defining the phrase “play a substantial role in the preparation or furnishing of an audit report”), including conforming amendments for the term “lead auditor” in Appendix 3.

- Obtain a written affirmation from the other auditor that its engagement team members possess the knowledge, skill, and ability to perform the assigned tasks. (AS 2101.06Hb)
- Determine that it can communicate with other auditors and gain access to their audit documentation. (AS 2101.06Hc)
- In multi-tiered audits, a first other auditor may assist the lead auditor in performing procedures with respect to second other auditors concerning independence and ethics requirements; the knowledge, skill, and ability of the second other auditors; and communications with second other auditors. (AS 2101.06E, .06I)
- Supervising the audit. AS 1201, *Supervision of the Audit Engagement*, as amended will require that the lead auditor:
 - Supervise other auditors under the Board’s standard on supervision of the audit engagement (AS 1201) when the lead auditor assumes responsibility for the other auditor’s work (i.e., does not divide responsibility for the audit with an other auditor).⁵⁸
 - Inform other auditors of the scope of their work and the following items with respect to the work requested to be performed: identified risks of material misstatement associated with the location or business unit, tolerable misstatement, and the amount (if determined) below which misstatements are clearly trivial and do not need to be accumulated. (AS 1201.08)
 - Obtain and review the other auditor’s written description of procedures to be performed and discuss with, and communicate in writing to, the other auditor any needed changes to the planned procedures. (AS 1201.09–.10)
 - Obtain and review a written affirmation from the other auditor as to whether the other auditor has performed work in accordance with the lead auditor’s instructions, and, if the other auditor has not performed such work, 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. (AS 1201.11)

⁵⁸ The work of engaged assistants from outside the firm (e.g., leased staff, secondees, staff from a shared service center) will be governed by the same standards that apply to the work of assistants inside the firm (e.g., firm partners, shareholders, employees), including the supervision provisions in AS 1201.05–.06. See, e.g., Staff Audit Practice Alert No. 6, at 7–11 (July 12, 2010) (discussing engaging assistants from outside the firm).

- Direct other auditors to provide specified documentation concerning work performed.⁵⁹ (AS 1201.12)
- Determine whether the other auditor performed the work as instructed and whether additional audit evidence needs to be obtained. (AS 1201.13)
- Evaluate, in a multi-tiered audit where the lead auditor seeks assistance from a first other auditor to perform any of the above responsibilities with respect to second other auditors,⁶⁰ the first other auditor's supervision of second other auditors. (AS 1201.14)
- Dividing responsibility for the audit. When the lead auditor divides responsibility for the audit with another accounting firm, new auditing standard AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*, will provide that:
 - The lead auditor should determine that audit procedures are performed to test and evaluate the consolidation or combination of the financial statements of the business units audited by the referred-to auditor into the company's financial statements. (AS 1206.03)
 - The lead auditor should communicate in writing to the referred-to auditor the plan to divide responsibility for the audit. (AS 1206.04)
 - The lead auditor should obtain written representation from the referred-to auditor that it is independent under PCAOB and SEC requirements and duly licensed to practice. (AS 1206.05)
 - The lead auditor may divide responsibility for the audit with a referred-to auditor only if:
 - The referred-to auditor represents it performed its audit and issued its report in accordance with PCAOB standards;
 - The lead auditor determines that the referred-to auditor is familiar with the relevant financial reporting requirements and PCAOB standards;
 - The referred-to auditor is registered with the PCAOB if it played a substantial role in the audit or its report is with respect to a business unit that is itself an issuer, broker, or dealer;
 - In case of the conversion of business unit financial statements from another financial reporting framework to the financial reporting framework of the

⁵⁹ Under PCAOB standards, the lead auditor's necessary extent of review of the other auditors' documentation depends on the necessary extent of supervision by the lead auditor (*see* AS 1201.06). The documentation to be reviewed by the lead auditor should include, at a minimum, the documentation described in AS 1215.19.

⁶⁰ For a more detailed discussion of multi-tiered audits, see Section V of Appendix 4 of this release.

company, the lead auditor or the referred-to auditor audits the conversion adjustments, and the lead auditor indicates in its report which auditor was responsible for that. (AS 1206.06)

- In situations where the lead auditor is unable to divide responsibility, the lead auditor should: plan and perform procedures necessary to issue an auditor's report that expresses an opinion; qualify or disclaim an opinion; or withdraw from the engagement. (AS 1206.07)
- The lead auditor's audit report must indicate clearly the division of responsibility, identify the referred-to auditor by name and refer to its report, and disclose the magnitude of the portion of the financial statements (or internal controls over financial reporting) audited by the referred-to auditor. (AS 1206.08)
 - If the referred-to auditor's report is not a standard (i.e., unqualified) report, the lead auditor should make reference to the departure, unless the matter is clearly trivial to the financial statements. (AS 1206.09)
- Additional amendments. The amendments the PCAOB is adopting will also:
 - Rescind AS 1205, *Part of the Audit Performed by Other Independent Auditors*.
 - This change, in effect, requires lead auditors to supervise (directly or through other auditors) work performed by other auditors under AS 1201 in all cases, unless the lead auditor divides responsibility for the audit with another (referred-to) auditor, in which case AS 1206 applies.
 - Revise AS 1015, *Due Professional Care in the Performance of Work*, to emphasize that other auditors are responsible for performing their work with due professional care.
 - Revise AS 1215 to expressly state that, in an audit involving other auditors, an other auditor must retain documentation of the work that it performs, and that its documentation is subject to the requirements related to subsequent modification.
 - 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.
 - Include definitions of key terms "engagement team," "lead auditor," "other auditor," and "referred-to auditor" in AS 2101.
 - Revise other PCAOB standards and rules to conform to these amendments.

IV. ECONOMIC ANALYSIS

The Board is mindful of the economic impacts of its standard setting. This economic analysis describes the economic baseline, economic need, expected economic impacts of the amendments, and alternative approaches considered. Because there are limited data and research findings available to estimate quantitatively the economic impacts of the amendments, the Board's economic discussion is qualitative in nature. However, where practicable, the analysis incorporates quantitative information, including analysis of Form AP data and PCAOB inspections findings.

The Board has sought information relevant to the economic analysis over the course of this rulemaking.⁶¹ To the extent that commenters expressed views related to the economic analysis, commenters generally found the economic analysis in the 2016 Proposal and the discussion of economic topics in the 2017 and 2021 SRCs to be reasonable. Commenters did not provide additional quantitative data or research that could be used in the analysis. The Board has considered all comments received and has developed the following economic analysis that evaluates the expected benefits and costs of the final amendments, discusses potential unintended consequences, and facilitates comparison to alternative actions considered.

A. Baseline

Section II above describes current PCAOB standards that apply specifically when other auditors and referred-to auditors participate in an audit and the influence of other standard setters on audit practice in this area. This section expands on that discussion by describing the economic baseline against which the impact of the amendments can be considered. Specifically:

- Section IV.A.1 discusses the extent of the use of other auditors and referred-to auditors by analyzing data in AuditorSearch, which is the PCAOB's public Form AP database.⁶²
- Section IV.A.2 summarizes auditing practices related to the use of other auditors and referred-to auditors, including PCAOB staff analysis of audit firm methodologies and data on deficiencies in audits that involve other auditors.

⁶¹ See 2016 Proposal at 30-49; 2017 SRC at 42; 2021 SRC at 62.

⁶² See <https://pcaobus.org/resources/auditorsearch>. See also *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 terms "other auditors" and "referred-to auditors" in the analysis presented in this section refer only to accounting firms.

- Section IV.A.3 provides a concise survey of academic research on the use of other auditors and its impact on audit quality.

1. Extent of the Use of Other Auditors and Referred-to Auditors

As discussed in the 2016 Proposal, many companies have significant operations in jurisdictions outside the country or region of the lead auditor.⁶³ Audits of such multinational businesses often require the participation of accounting firms other than the lead auditor and can often involve multiple other firms.⁶⁴ The use of other auditors is also more prevalent in audits of larger companies audited by larger accounting firms.⁶⁵ In addition, work performed by other auditors can comprise a significant share of a given audit.⁶⁶

Observations in the 2016 Proposal regarding the use of other auditors and referred-to 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 accounting firms in audits on PCAOB's Form AP. Figures 2, 3, and 4 present staff analysis of Form AP filings between January 1, 2021, and December 31, 2021, and update similar information presented in the 2021 SRC.⁶⁷

⁶³ See 2016 Proposal at 6.

⁶⁴ See *id.* at 6 note 4.

⁶⁵ See *id.* at 7.

⁶⁶ See *id.* at 6-7 and note 5 (noting that in audits selected by the PCAOB for inspection in 2013 and 2014 that involved other auditors, the other auditors audited on average between one-third and one-half of the total assets and total revenues of the company being audited).

⁶⁷ See 2021 SRC at 49-55 (providing data based on Form AP filings in 2020). The analysis of Form AP data presented in Figures 2, 3, and 4 is limited to issuers other than investment company vehicles and employee benefit plans.

Figure 2. Extent of Use of Other Auditors (2021)

	Percentage of audits that use other auditors	Maximum number of other auditors used in an audit
All issuer audits	26%	63
By audit firm type⁶⁸		
U.S. GNF	39%	27
Non-U.S. GNF	58%	63
U.S. NAF	7%	10
Non-U.S. NAF	13%	17
By issuer domicile		
U.S. issuers	23%	27
Non-U.S. issuers	41%	63
By issuer size		
Fortune 500 issuers	68%	27
Large accelerated filers	57%	63
Accelerated filers	36%	14
Non-accelerated filers	12%	21

Sources: 2021 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 includes referred-to auditors and refers only to other accounting firms and not individual accountants at those firms.⁶⁹

⁶⁸ Global network firms ("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.

The statistics presented in Figure 2 describe the percentage of issuer audits that use other firms and the maximum number of other firms used in an individual audit, based on 2021 Form AP filings. The results are largely consistent with the 2020 Form AP data presented in the 2021 SRC and indicate that other firms are involved in many audits of issuers.

Overall, other firms are involved in about 26 percent of all issuer audit engagements.⁷⁰ Their use is especially common in audits performed by firms that are members of global networks; about 39 percent of U.S. GNF engagements and about 58 percent of non-U.S. GNF engagements involved the use of other firms. In comparison, only about seven percent of U.S. NAF and 13 percent of non-U.S. NAF audit engagements involved other firms.

When analyzed from the perspective of the domicile of the issuer, other firms are involved in about 23 percent of audit engagements of issuers domiciled in the U.S., and about 41 percent of audit engagements of issuers domiciled outside the U.S. Alternately, when analyzed by issuer size, other firms are involved in about 68 percent of Fortune 500 issuer audits and about 57 percent of large accelerated filer audits.⁷¹ In contrast, only about 36 percent of accelerated filer audits and about 12 percent of non-accelerated filer audits involved the use of other firms.

Some issuer audits involve many other firms, particularly when the issuer is large. For example, the audit of one Fortune 500 issuer involved 27 other firms and the audit of one large

accounting firms registered with the Board that are not GNFs. Some of the NAFs belong to international networks.

⁶⁹ Disclosures on Form AP include the name, extent of participation, and headquarters location of an other accounting firm that participated in an audit and contributed 5% or more of the total audit hours. For firms that contributed less than 5% of the total audit hours, the number of firms and their aggregate extent of participation is disclosed. Form AP reporting is required not only in situations when an other accounting firm performed part of an audit under AS 1201 or AS 1205, but also when the personnel of an other accounting firm, but not the firm itself, was involved in the lead auditor's audit. See Form AP, Item 3.2 (Note) (providing that an other accounting firm participated in the lead auditor's audit for Form AP reporting purposes if any of its principals or professional employees was subject to supervision under AS 1201). See also footnote 62 above. Thus, not all of the audits in the table may have involved, and not all of the firms in the table may have been, other auditors that performed part of the audit under AS 1205 or were themselves supervised under AS 1201.

⁷⁰ The 2021 SRC presented data showing that other firms were involved in about 30 percent of all issuer audit engagements. See 2021 SRC at 51. The change from 30 percent in the 2021 SRC to 26 percent in this release appears to be mostly due to the recent increase in special purpose acquisition company audits, which rarely involve the participation of other firms. Between 2018 (the first full year of Form AP data) and 2020 (the year presented in the 2021 SRC), the percentage of audits that use other firms remained relatively stable.

⁷¹ For an explanation of accelerated filer criteria, see <https://www.sec.gov/corpfin/secg-accelerated-filer-and-large-accelerated-filer-definitions>.

accelerated filer involved 63. By contrast, the maximum number of other firms used on an audit of an accelerated filer and a non-accelerated filer was somewhat lower, at 14 and 21 other firms, respectively. The maximum number of other firms used is highest for issuer audits conducted by GNFs. For example, one non-U.S. GNF audit involved 63 other firms and one U.S. GNF audit used 27. Non-affiliated firms can also use multiple other firms when conducting issuer audits; on one audit a non-U.S. NAF used 17 other firms and one U.S. NAF audit involved 10.

Figure 3. Audits Involving Multiple Other Auditors (2021)

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	61%	28%	11%	2%
By audit firm type				
U.S. GNF	66%	32%	11%	1%
Non-U.S. GNF	71%	31%	16%	4%
U.S. NAF	19%	2%	0%	0%
Non-U.S. NAF	34%	5%	5%	0%
By issuer domicile				
U.S. issuers	61%	28%	9%	1%
Non-U.S. issuers	64%	29%	14%	4%

Sources: 2021 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 includes referred-to auditors and refers only to other accounting firms and not individual accountants at those firms. See footnote 69 above.

The statistics shown in Figure 3 describe how often more than one other firm is used when an audit involves such use, based on 2021 Form AP filings. The results are largely consistent with the 2020 Form AP data presented in the 2021 SRC and indicate that when other firms are used, it is common that multiple other firms are used.⁷² For example, among all issuer audits involving the use of other firms, about 61 percent involved two or more other firms,

⁷² 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.

about 28 percent involved five or more, about 11 percent involved ten or more, and about two percent involved twenty or more. 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 firms than NAFs do. For example, in issuer audits conducted by U.S. GNFs that involved other firms, about 66 percent involved two or more other firms, about 32 percent involved five or more, about 11 percent involved ten or more, and about one percent involved twenty or more. Similarly, in audit engagements of issuers conducted by non-U.S. GNFs that involved other firms, about 71 percent involved two or more other firms, about 31 percent involved five or more, about 16 percent involved ten or more, and about four percent involved twenty or more. By contrast, in audit engagements of issuers conducted by U.S. NAFs that involved other firms, only about 19 percent involved two or more other firms, and about two percent involved five or more. In audit engagements of issuers conducted by non-U.S. NAFs that involved other firms, about 34 percent involved two or more other firms, and about five percent involved five or more.

Figure 4. Other Auditors' Share of Total Audit Hours (2021)

	Percentage of audits involving other auditors where other auditors performed: ⁷³	
	10% or more of total audit hours	30% or more of total audit hours
All issuer audits	52%	19%
By audit firm type		
U.S. GNF	52%	13%
Non-U.S. GNF	58%	34%
U.S. NAF	37%	18%
Non-U.S. NAF	63%	41%
By issuer domicile		
U.S. issuers	48%	12%
Non-U.S. issuers	61%	35%

Sources: 2021 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 includes referred-to auditors and refers only to other accounting firms and not individual accountants at those firms. See footnote 69 above.

The statistics presented in Figure 4 describe the share of audit work performed by other firms, based on 2021 Form AP filings. The other firms' share of total audit hours provides a simple measure of the significance of their work, but may not reflect the level of risk associated with that work. The results are largely consistent with the 2020 Form AP data presented in the 2021 SRC and show that work performed by other firms can, however, account for a significant share of the audit. To illustrate this finding, consider the following data regarding the frequency with which other firms' hours exceeded a relatively lower (10 percent of total audit hours) and relatively higher (30 percent) threshold of other auditor involvement.

⁷³ Using a higher threshold of other firms' involvement (50 percent of total audit hours) would further reduce the percentages reported in Figure 4. Specifically, in audits of issuers that involved other firms, other firms performed more than 50 percent of total audit hours in about six percent of all issuer audits, about two percent of U.S. GNF audits, about 16 percent of non-U.S. GNF audits, about four percent of U.S. NAF audits, and about 29 percent of non-U.S. NAF audits.

Looking first at the relatively lower threshold of involvement, in audits of issuers that involved other firms, other firms performed more than 10 percent of total audit hours in about 52 percent of all issuer audits, about 52 percent of U.S. GNF audits, about 58 percent of non-U.S. GNF audits, about 37 percent of U.S. NAF audits, and about 63 percent of non-U.S. NAF audits. When examined by the domicile of the issuer, other firms performed more than 10 percent of the total audit hours in about 48 percent of audits of issuers domiciled in the U.S., and about 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 firms, other firms performed more than 30 percent of the total audit hours in about 19 percent of all issuer audits, about 13 percent of U.S. GNF audits, about 34 percent of non-U.S. GNF audits, about 18 percent of U.S. NAF audits, and about 41 percent of non-U.S. NAF audits. Other firms performed more than 30 percent of the total audit hours in about 12 percent of audits of issuers domiciled in the U.S., and about 35 percent of audits of issuers domiciled outside the U.S.

2. Auditing Practice Related to the Use of Other Auditors and Referred-to Auditors

i. PCAOB Staff Analysis of Audit Methodologies

PCAOB staff has reviewed the methodologies of firms related to the use of other auditors and referred-to auditors. Specifically, the staff compared methodologies of GNFs and methodologies commonly used by smaller U.S. firms to current PCAOB standards and the amendments. The staff performed this analysis to understand the extent to which firms would need to update their methodologies to implement the amendments and new standard.

In general, the staff observed that the methodologies of larger firms already incorporate some of the concepts included in the amendments and new standard. For example, methodologies of larger firms increasingly emphasize the responsibility of the lead auditor for overseeing the work of other auditors using a risk-based approach. Some larger firms have also made changes to their audit methodologies in recent years 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 also 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 U.S. firms' methodologies generally do not require the lead auditor to perform or consider supervisory procedures beyond the requirements of AS 1205.

The staff's analysis of audit methodologies also identified variation in the extent to which larger firms have already incorporated the amendments and new standard in their methodologies. For example, the staff observed that some larger firms' methodologies do not yet incorporate the amendments to supervisory procedures in multi-tiered audits or the amendments to AS 1220 regarding engagement quality reviews. Similarly, many firms may need

to revise their approaches to determining whether the firm's participation in an audit is sufficient for it to serve as lead auditor.

Commenters on the 2016 Proposal who addressed audit methodologies regarding the use of other auditors and referred-to auditors generally agreed that the Proposal accurately described existing audit practices. Some of those commenters indicated that many firms, particularly larger and mid-size firms, have updated their methodologies to comply with the relevant standards of the PCAOB, IAASB, and ASB. Another commenter indicated that firms utilize a range of approaches to group audits to address the varied business structures of their audit clients.

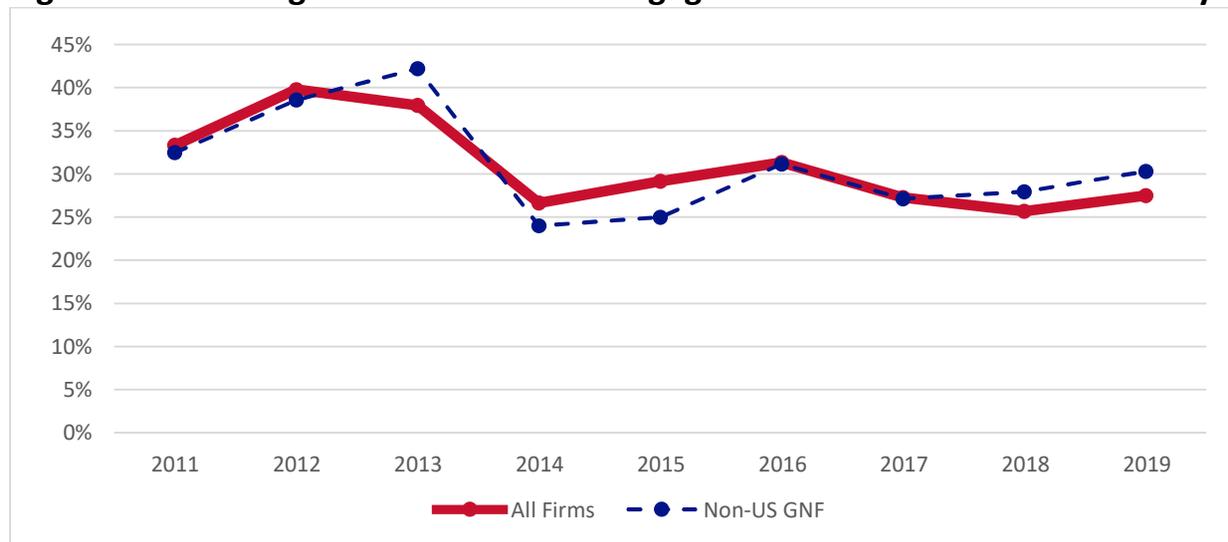
A commenter on the 2021 SRC observed the increased use of technology in auditing, which accelerated in response to the global COVID-19 pandemic. Some stated that, as a result of the use of technology, audit firms increasingly digitize their documentation and are able to communicate more efficiently. Others observed that the increased use of technology has permitted the remote performance of audit work, and that physical location is not as important as it was previously. One commenter noted changes in the management of audits, including the increased use of shared service centers and the existence of more complex group audit structures. Some commenters, however, stated that they had not seen significant changes in auditor practices related to the use of other auditors.

ii. Deficiencies in Audits Involving Other Auditors

Section II.C above discusses observations from recent PCAOB inspections and PCAOB and SEC enforcement cases related to the work of other auditors and lead auditors. This section supplements the discussion in Section II.C by describing data regarding deficiencies in work performed by other auditors (or "referred work engagements").

Over the last decade, PCAOB inspections staff has observed Part I.A deficiencies⁷⁴ in roughly 25 to 45 percent of referred work engagements selected for review. As shown in Figure 5, 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.

⁷⁴ A Part I.A deficiency is identified through inspection and included in a PCAOB inspection report when it is "of such significance that 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>.

Figure 5. Percentage of Referred Work Engagements with a Part I.A Deficiency

3. Academic Research on the Use of Other Auditors

As discussed in Section IV.A.1, 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.⁷⁵

If the cost to the auditor of overcoming these challenges (e.g., through additional supervision of other auditors) exceeds the lead auditor's perception of the benefits of doing so (e.g., in terms of reduced risks of litigation, reputational loss, and regulatory sanction, as a result of improving audit quality), then audit quality may suffer.⁷⁶ The impact on audit quality could be especially significant because the lead auditor makes important decisions about how the audit is performed, including whether the lead auditor performs a sufficient portion of the audit to issue the audit report.

Although relatively few empirical studies have explicitly examined the relationship between the use of other auditors and audit quality, several papers have been published recently that shed light on this issue. This growing body of research suggests that there is a relationship between the use of other auditors and audit quality, and that the facts and

⁷⁵ See 2016 Proposal at 29-30 and notes 61-64; see also 2021 SRC at 55 and note 147.

⁷⁶ See 2016 Proposal at 29 note 61.

circumstances of the audit may be influential in determining whether this is a positive or negative relationship.⁷⁷

B. Need

This section discusses the problem that the amendments are intended to address and explains how the amendments are expected to address it. Specifically, an incentive problem may arise from information asymmetries between investors and the lead auditor and between the lead auditor and other auditors, among other factors. The amendments will help address the problem by increasing the accountability of the lead auditor and requiring a more uniform, risk-based approach to the lead auditor's planning and supervision of the work of other auditors. The amendments aim to clarify and strengthen the lead auditor's planning and supervisory requirements to provide lead auditors with better direction and a stronger regulatory incentive to more consistently produce high quality audits when using other auditors. The amendments will 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.

1. Problem to Be Addressed

As discussed in the 2016 Proposal, incentive problems may arise from information asymmetry between investors and the lead auditor.⁷⁸ Specifically, in audits involving other auditors, a market failure⁷⁹ may be caused, at least in part, by an information asymmetry between investors and the lead auditor regarding 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. The uncertainty may reduce public confidence in financial information, decrease the efficiency of capital allocation decisions, and increase the cost of capital.⁸⁰

⁷⁷ See 2016 Proposal at 29 note 61; see also 2021 SRC at 56 notes 148-149 (citing academic research); see also Elizabeth Carson, Roger Simnett, Ulrike Thürheimer, and Ann Vanstraelen, *Involvement of Component Auditors in Multinational Group Audits: Determinants, Audit Quality, and Audit Fees* (2022) (accepted for publication in *Journal of Accounting Research*; available at <https://doi.org/10.1111/1475-679X.12418>) (“[I]nvolvement of component auditors benefits audit quality as long as the principal auditor conducts a substantial amount of work. Once the involvement of component auditors exceeds a certain level, audit quality decreases.”).

⁷⁸ See 2016 Proposal at 30-33 and notes 66-73.

⁷⁹ The term “market failure” refers to a situation in which markets fail to function efficiently. See 2016 Proposal at 31 note 67.

⁸⁰ See 2016 Proposal at 37 note 78.

Because of this information asymmetry and other factors such as cost considerations, the lead auditor may not be adequately motivated 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, leading to a moral hazard problem.⁸¹

Further, as discussed in the 2021 SRC, incentive problems may also arise from information asymmetry between lead auditors and other auditors.⁸² 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.⁸³ Other auditors also may not be sufficiently incentivized to perform sufficient and appropriate audit procedures. A commenter on the 2021 SRC agreed that information asymmetry may exist between auditors.

2. How the Amendments Will Address the Need

The amendments are expected to increase the accountability of the lead auditor and require a more uniform, risk-based approach to the lead auditor's oversight of other auditors. Specifically, the amendments rescind AS 1205 and amend AS 2101 and AS 1201 to apply in all situations in which the lead auditor involves other auditors. The amendments include additional risk-based requirements to provide the lead auditor with more specificity and clarity about the lead auditor's supervisory responsibilities.

Strengthening the performance requirements for lead auditors can augment the lead auditor's incentive to monitor the performance of other auditors through adequate supervision of other auditors' work. By addressing more clearly the responsibilities of the lead auditor (e.g., for planning the audit and supervising other auditors), the 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. Investors should form expectations of audit quality under the more standardized and improved supervisory framework, and thus should have greater certainty about the lead auditor's approach to supervision and the quality of the audit.⁸⁴ Additionally, by adding specificity and

⁸¹ The term "moral hazard" refers to a situation in which an agent could take actions (such as not putting forth sufficient effort) that are difficult for the principal to monitor and would benefit the agent at the expense of the principal. See 2016 Proposal at 31 note 69; *Amendments to Auditing Standards for Auditor's Use of the Work of Specialists*, PCAOB Release No. 2018-006 (Dec. 20, 2018), at 40-42.

⁸² See 2021 SRC at 61.

⁸³ See 2016 Proposal at 19-21.

⁸⁴ See 2016 Proposal at 35 note 75 (citing academic research).

reducing ambiguity regarding the lead auditor's responsibilities, the amendments address risks arising from potential systematic, welfare-decreasing auditor and investor errors in judgment.⁸⁵

Examples of amendments that are expected to strengthen and clarify the performance requirements for lead auditors and augment their incentive to monitor the performance of other auditors include the following:

- In audits involving other auditors, the amendments to AS 2101 and AS 1220 will 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, and the engagement quality reviewer's evaluation of that assessment. In addition, in audits that involve work performed by other auditors regarding locations or business units, the lead auditor's involvement (through planning and performing audit procedures and supervising other auditors) will be required to be commensurate with the risks of material misstatement associated with those locations or business units. The amendments also describe the actions that the lead auditor should take with respect to each other auditor to determine compliance with independence and ethics requirements. Further, the amendments have specific requirements regarding the lead auditor's responsibilities with respect to the other auditors' knowledge, skill, and ability.
- Currently, lead auditors can apply two different approaches: supervising the other auditors' work under AS 1201 or using the work and reports of other auditors under AS 1205. Under the amendments, AS 1205 will be rescinded, and lead auditors will be required to supervise other auditors under the amended AS 1201 when they assume responsibility for the other auditors' work.

The amendments to AS 1201 provide additional direction to the lead auditor on how to apply the principles-based provisions of the standard to the supervision of other auditors. For example, the amendments require the lead auditor to: (i) inform other auditors of the scope of their work and, with respect to such work requested, the identified risks of material misstatement, tolerable misstatement, and clearly trivial amounts (if determined); (ii) obtain and review the other auditor's written description of procedures to be performed, and discuss with, and communicate in writing to, the other auditor any needed changes to the planned procedures; (iii) obtain and review a written affirmation from the other auditor as to whether the other auditor has performed work in accordance with the lead auditor's instructions, and, if it has not, a description of the nature of, and an explanation of the reasons for, the instances where work was not performed in accordance with the instructions, including (if applicable) a description of the alternative work performed; (iv) direct other auditors to provide specified documentation regarding

⁸⁵ See 2021 SRC at 61 note 175.

work performed; and (v) determine whether the other auditor performed the work as instructed and whether additional audit evidence needs to be obtained.⁸⁶

C. Economic Impacts

This section discusses the expected benefits and costs of the amendments and potential unintended consequences. Overall, the magnitude of the benefits and costs is likely to be affected by the extent to which other auditors are involved in audits, including the number of other auditors used and the amount of time spent by other auditors. Benefits and costs are also likely to be affected by the nature of the work and the risks involved in the work performed by other auditors, because more complex work and work in areas of greater risk will likely require greater supervisory efforts by the lead auditor. In addition, benefits and costs are likely to be affected by the degree to which accounting firms have already adopted audit practices that are similar to those the amendments will require. Overall, the Board expects that the benefits of the amendments will justify any costs and unintended negative effects.

1. Benefits

As discussed above in Section IV.B, the amendments are expected to benefit investors and the public by mitigating information asymmetries between investors and the lead auditor and between the lead auditor and other auditors. The new requirements should strengthen the supervision of other auditors, which in turn should improve audit quality and increase the likelihood that auditors detect material misstatements in the financial statements and material weaknesses in internal controls over financial reporting. Improving the quality of audits and financial reporting can reduce investors' uncertainty about the information being provided in company financial statements, foster increased public confidence in the financial markets, and enhance capital formation. In particular, improving the quality of the information available to financial markets can increase the efficiency of capital allocation decisions and decrease the cost of capital.⁸⁷

Specifically, the amendments address audit deficiencies of other auditors that continue to be observed in practice (see Figure 5 above) and provide more transparency to investors about how lead auditors supervise other auditors by increasing the accountability of the lead auditor and introducing a more uniform, risk-based approach to the lead auditor's supervision of other auditors. The amendments require the lead auditor to determine the sufficiency of its participation in the audit based on quantitative and qualitative factors and be better informed about the qualifications and performance of the other auditor. The amendments also increase

⁸⁶ The amendments for the planning and supervision of other auditors also include provisions, in AS 1201 and AS 2101, that are designed to make the standard scalable for multi-tiered audits in which the lead auditor may seek assistance from a first other auditor in supervising second other auditors.

⁸⁷ See 2016 Proposal at 37 note 78.

the requirements for the lead auditor to monitor and review (i.e., supervise) the work of other auditors.

Investors also may benefit from the amendments indirectly. For example, under existing standards, the auditor is required to communicate to the audit committee its overall audit strategy, significant risks, and results of the audit, including work performed by other auditors, among other things.⁸⁸ Because of the lead auditor's enhanced involvement in the work of other auditors, the quality of communications with audit committees could also be enhanced, specifically as it relates to risks of material misstatements in the financial statements related to the component(s) of the company audited by the other auditor(s). Such enhanced discussions with the audit committee could improve the audit committee's oversight of the audit by highlighting areas where audit committees and companies should increase attention to ensure the quality of their financial statements, including related disclosures. This increased attention by audit committees and companies could result in higher quality financial reporting, which benefits investors.

We expect that the amendments will lead to improved supervision of other auditors' work and an increase in audit quality. Auditors also may benefit from the amendments due to the reduced risk of failure to detect material misstatements. As a result, associated costs such as the risk of litigation, regulatory sanction, or reputational loss faced by auditors could decrease.

Some commenters provided information responding to the discussion of potential benefits to investors and other financial statement users. One commenter said that many of the changes contemplated in the 2016 Proposal would improve the quality of audits involving other auditors and benefit investors. Another commenter stated that the proposed changes should decrease the overall likelihood of misstatement by enhancing the verification process of information relied upon by other auditors, and therefore should serve as added safeguards for investors and the general public through their ability to rely on the financial statement data and related disclosures. Another commenter said that the proposed amendments would provide more transparency about audits involving other auditors and would therefore benefit investors and the public. Similarly, in response to the 2021 SRC, commenters agreed that the amendments would enhance audit quality and protect the interests of investors. These comments are consistent with the benefits identified in this section.

2. Costs

The Board recognizes that imposing new requirements may result in additional costs to auditors and the companies they audit.

⁸⁸ See paragraphs .09–.24 of AS 1301, *Communications with Audit Committees*.

Auditors may incur certain fixed costs (costs that are generally independent of the number of audits performed) related to implementing the amendments. These include costs to update audit methodologies and tools, and to prepare training materials and conduct training. Large firms are likely to update methodologies using internal resources, whereas small firms are more likely to purchase updated methodologies from external vendors.⁸⁹ The costs to update methodologies likely depend on the extent to which the new requirements have already been incorporated in the firms' current methodologies. For firms that have implemented supervisory procedures like those required by the amendments, the costs of updating methodologies may be lower than for firms that currently do not have such procedures. Larger accounting firms, which often perform audits involving other auditors, will likely take advantage of economies of scale by distributing fixed costs over a larger number of audit engagements. Smaller accounting firms, which less often perform audits that involve other auditors, will likely distribute their fixed costs over fewer audit engagements.

In addition, auditors may incur certain engagement-level variable costs related to implementing the amendments. For example, to implement the additional requirements, both lead auditors and other auditors may:

- Increase the number of engagement team members and engagement quality reviewer assistants; or
- Increase the amount of time incurred by the existing team members and engagement quality reviewers and their assistants.⁹⁰

The magnitude of the variable costs likely depends on several factors. For firms that have required greater lead auditor involvement and already have applied some of the new requirements in practice, the variable costs may be lower than for firms that currently require less lead auditor involvement. The variable costs are also likely to be affected by the nature of the engagement, including the extent of involvement of other auditors (e.g., the number of other auditors used and the amount of time spent by other auditors), and the level of risk associated with the audit work performed by other auditors. Finally, the total variable costs are related to the number of audits using other auditors.

Since the total fixed and variable costs of the amendments likely depend on the interaction of all the factors discussed above, it is not clear whether these costs, as a percentage of total audit costs, will be greater for larger or for smaller accounting firms.

⁸⁹ See 2016 Proposal at 38.

⁹⁰ The 2016 Proposal also mentioned the potential additional costs incurred by traveling to a company's locations or business units at which audit procedures are to be performed. See 2016 Proposal at 38. As remote work and virtual meetings became more common in recent years, these costs may be less significant.

For audits in which the lead auditor divides responsibility for the audit with another accounting firm, the anticipated impact of the amendments on the lead auditor's costs is not likely to be significant. Currently, about 40 audits per year involve divided responsibility, and the amendments to PCAOB standards that apply to those scenarios are not as significant as other amendments.

In addition to auditors, companies being audited may also incur costs related to the amendments, both directly and indirectly. Companies could incur direct costs from engaging with or otherwise supporting the auditor performing the audit. For example, some companies could face costs of producing documents and responding to additional auditor requests for audit evidence, due to more rigorous evaluation of audit evidence by lead and other auditors. To the extent that auditors incur higher costs to implement the amendments and are able to pass on at least part of the increased costs through an increase in audit fees, companies could incur an indirect cost.⁹¹

In response to the 2016 Proposal, one commenter agreed that the incremental cost due to the 2016 Proposal is likely to be limited because some accounting firms already had implemented many aspects of the 2016 Proposal in their methodology and/or in practice, and because of the risk-based approach taken in the 2016 Proposal. Another commenter stated that audit firms not already complying with the requirements would experience higher costs, but most firms already performed audits under GAAS standards, and for them the increased costs would not be prohibitive. In response to the 2021 SRC, two commenters described potential increased costs when the lead auditor and other auditor are part of the same network. The commenters suggested that the potential increased costs would be caused by the inability to sufficiently leverage common systems of quality control, resulting in unnecessary effort to understand the other auditor's audit procedures. As discussed in the 2017 and 2021 SRCs, however, affiliation through a network does not automatically provide the lead auditor with an understanding of the other affiliates' processes and experience.⁹² One commenter recommended the PCAOB consider the difficulties encountered and resources used by firms in complying with PCAOB standards, AICPA AU-Cs, and IAASB ISAs. The Board's considerations are discussed in Section IV.D.2.iii below.

3. Potential Unintended Consequences

In addition to the benefits and costs discussed above, the amendments could have unintended economic impacts. The 2016 Proposal described a number of potential unintended consequences, resulting in public comments on those topics and others. This section discusses the potential unintended consequences as well as the Board's consideration of such

⁹¹ See 2016 Proposal at 40 note 80.

⁹² See 2017 SRC at 14; 2021 SRC at 24.

consequences in adopting the amendments.⁹³ The discussion also addresses, where applicable, factors that mitigate the potential consequences, including revisions to the proposed amendments reflected in the amendments the Board is adopting and the existence of other countervailing factors.

i. Accountability of Other Auditors

Unlike AS 1205, AS 1201 does not contain a statement that “the other auditor remains responsible for the performance of his own work and for his own report.” Thus, it is possible that the other auditor could feel less accountable given that the amendments focus the responsibility for providing direction and supervision of the other auditor on the lead auditor. If this occurred, audit quality could decrease.

Commenters expressed differing views on the 2016 Proposal’s potential impact on other auditors’ accountability. Several commenters stated that the proposed amendments would not diminish other auditors’ overall accountability. Other commenters stated that if the amendments are applied correctly, the lead auditor’s supervision should hold the other auditors to a higher level of overall accountability and improve the overall quality of other auditors’ work.

Other commenters expressed concern that the 2016 Proposal did not include the statement in AS 1205.03 about other auditors’ responsibility. Omitting this provision, in their view, may be interpreted as a reduction in the responsibility and accountability of other auditors, which could have adverse effects on audit quality. Some commenters recommended retaining the existing provision or including an analogous requirement to address the other auditors’ responsibility.

To mitigate this potential negative consequence, AS 1015 is being amended to emphasize that the other auditors are responsible for performing their work with due professional care.⁹⁴ This amendment was proposed in the 2017 SRC and supported by commenters. Notably, under the amended standards, the other auditor remains responsible for performing its assigned work with due professional care and otherwise in conformance with

⁹³ In addition to the potential unintended consequences discussed in this section, potential results of certain other aspects of the proposed amendments were described by some commenters as “unintended.” These and other comments are discussed in Appendix 4 of this release in conjunction with the following aspects of the final amendments: the sufficiency-of-participation determination for serving as the lead auditor (Section III.A. of Appendix 4); other auditors’ compliance with independence and ethics requirements (Section III.B. of Appendix 4); other auditors’ knowledge, skill, and ability (Section III.D.1 of Appendix 4); informing other auditors of their responsibilities (Section IV.B.1 of Appendix 4); directing other auditors to perform certain supervisory procedures in a multi-tiered audit (Section V of Appendix 4); and dividing responsibility for the audit (Section VI of Appendix 4).

⁹⁴ The PCAOB’s underlying standards governing the work of other auditors and referred-to auditors will similarly continue to apply to their work.

PCAOB standards. This responsibility is reflected in the auditor documentation the other auditor must prepare regarding the work performed, including written affirmation to the lead auditor regarding whether the other auditor performed its work in accordance with the lead auditor's instructions, including applicable PCAOB standards. In addition, the other auditor's work is subject to greater oversight by the lead auditor under the amended standards, which will reduce the other auditor's opportunities for performing insufficient work without detection. Finally, the other auditor's work continues to be subject to PCAOB oversight activities due to its participation in the audit.

ii. Time of Lead Auditor

Because lead auditor personnel will be required to perform additional supervisory responsibilities, such team members might have less time to perform other work on the same engagement. This could potentially reduce the likelihood that the auditor detects material misstatements in the portion of the financial statements for which the lead auditor performs procedures and could potentially lead to inefficient allocation of audit resources. Several commenters on the 2016 Proposal agreed that this potential unintended consequence could arise, adding that the increased planning and supervisory effort required of the lead auditor could also leave less time for the lead auditor to consider important issues.

The Board's inclusion of risk-based supervision requirements in the amended standards is intended to mitigate the possibility that the lead auditor will neglect work it intends to perform because of the attention it devotes to other auditors. In particular, the additional supervisory procedures required for the lead auditor's supervision of work performed by other auditors are intended to provide the lead auditor with a basis for concluding whether the financial statements are free of material misstatement. Thus, under the amended standards, the lead auditor should be focusing its efforts on audit areas with the greatest risk of material misstatement to the financial statements, whether those areas are audited by the lead auditor directly or by an other auditor under the lead auditor's supervision. Further, as lead auditor personnel gain experience and become more efficient in applying the new requirements related to other auditors, the likelihood that the lead auditor misallocates its time and resources should decrease.

iii. Involvement by Other Auditors

In response to (i) the potential costs or any practical difficulties of supervising other auditors under the amended standards or (ii) the sufficiency-of-participation requirements, the lead auditor, in some circumstances, may decrease the share of work performed by other auditors and increase the share of its own work. While this may be an efficient and effective response in certain circumstances, limiting other auditors' involvement in the engagement may negatively affect audit quality to the extent the other auditors possess knowledge of important country-specific information. Two commenters on the 2016 Proposal agreed that this unintended consequence may arise.

This potential outcome, however, would be contrary to the following requirements in PCAOB standards:

- “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.”⁹⁵
- “The knowledge, skill, and ability of engagement team members with significant engagement responsibilities should be commensurate with the assessed risks of material misstatement.”⁹⁶
- Firms are required to have policies and procedures in place that provide reasonable assurance that the firm will undertake “only those engagements that the firm can reasonably expect to be completed with professional competence.”⁹⁷

In addition, legal restrictions in some countries that prohibit a foreign auditor from providing professional services in the country could limit a foreign lead auditor’s ability to take on more work and assign less work to other auditors in the country. The Board anticipates that lead auditors will find the appropriate balance between the lead auditor and other auditor involvement in the audit as accounting firms gain experience in implementing the new requirements and seek to maximize the effectiveness and efficiency of audit engagements.

iv. Occurrence of Divided Responsibility

Some auditors who currently use an other auditor’s work under AS 1205 may view compliance with the supervision requirements of AS 1201 (as amended) as too costly and decide instead to divide responsibility for the audit. Several commenters on the 2016 Proposal agreed that this unintended consequence may arise, although some of them added that the likelihood was low. There are limited research findings available regarding the division of responsibility,⁹⁸ and it is not clear how an increase in audits with divided responsibility would affect audit quality. To provide transparency about such situations, the amendments require

⁹⁵ AS 1015.06.

⁹⁶ Paragraph .05a of AS 2301, *The Auditor’s Responses to the Risks of Material Misstatement*.

⁹⁷ Paragraph .15a of QC 20, *System of Quality Control for a CPA Firm’s Accounting and Auditing Practice*.

⁹⁸ See 2016 Proposal at 42 and note 84; see also Juan Mao, Michael Ettredge, and Mary Stone, *Group Audits: Are Audit Quality and Price Associated with the Lead Auditor’s Decision to Accept Responsibility?*, 39(2) *Journal of Accounting and Public Policy* 1 (2020) (examining whether a lead auditor’s disclosure of its choice to accept or decline (i.e., divide) responsibility for the work of another firm is associated with differences in audit fees or audit quality, and finding that “[l]ead auditors accepting responsibility charge higher audit fees but provide audits of no higher quality, and possibly of even lower quality”).

that, in a divided-responsibility scenario, the lead auditor disclose in its audit report: (i) the part of the audit that is performed by another accounting firm; (ii) the magnitude of the portion of the company's financial statements audited by the referred-to auditor; (iii) the referred-to auditor's name; and (iv) which auditor (lead or referred-to) has audited the conversion adjustments when the financial statements of the company and its business unit are prepared using different financial reporting frameworks.⁹⁹

v. Impact on Smaller Firms

The amendments will likely have an economic impact on audits performed by smaller firms that use other auditors. This is because smaller firms (i) are less likely to perform today the procedures described in the amendments and (ii) generally lack the economies of scale to distribute the additional fixed costs over many audits.¹⁰⁰ The 2016 Proposal also noted that additional supervisory requirements could decrease competition in the audit market for audits involving other auditors if smaller firms are less able to compete with larger firms.¹⁰¹

Several commenters on the 2016 Proposal agreed that this unintended consequence may arise. One commenter stated that, for smaller firms, complying with the proposed supervisory responsibilities may increase costs to such an extent that some smaller firms may exit the market for audits involving other auditors. Another commenter said that it would be harder for smaller firms than for larger firms to meet the proposed threshold for serving as lead auditor.

However, as discussed in Section IV.A.1 above, staff analysis using Form AP data shows that smaller firms already perform relatively fewer audits that involve other accounting firms than larger firms, and when they do, they use fewer other accounting firms.¹⁰² Thus, any impact on competition in the overall audit market is likely to be relatively small.

The Board's risk-based and scalable approach to designing the amendments is also intended to maintain a level playing field for all auditors choosing to involve other auditors in their audit, regardless of their size. Scalability is a characteristic of policy that typically refers to circumstances where requirements are general enough (e.g., principles-based) to be adapted effectively and efficiently under different facts and circumstances. Risk-based requirements are usually scalable because the necessary level of audit effort varies depending on the level of complexity and risk. Thus, risk-based requirements are likely to be relatively efficient (or at least not inefficient), because the auditor's incentives and discretion are likely to result in costs being

⁹⁹ See paragraphs AS 1206.06d and .08. 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.

¹⁰⁰ See discussion in Section IV.C.2 above.

¹⁰¹ See 2016 Proposal at 43.

¹⁰² See Figures 2 and 3 in Section IV.A.1 above.

incurred primarily in circumstances involving a corresponding, and potentially larger, risk-mitigation benefit to investors.¹⁰³ Under the amendments, the lead auditor would be required to determine the extent of supervision of other auditors based on, among other things, the nature of work, and risk of material misstatement.

vi. Benefit From Additional Requirements

It is possible that some audits (e.g., those previously conducted under AS 1205) will not benefit from the new requirements. This could occur, for example, on very simple low-risk audits that involve highly qualified other auditors. In such circumstances, the lead auditor could incur incremental costs to comply with the additional planning and supervisory requirements in the amended standards without yielding a corresponding benefit to audit quality.

This inefficient outcome is mitigated by the risk-based and scalable aspects of the amended standards, which rely on the lead auditor to make judgments about the nature and extent of supervision of other auditors based on risks. The Board anticipates that as lead auditors gain experience implementing the new requirements, they will make appropriate judgments that are efficient and effective at achieving the desired level of audit quality. The Board received no comments on this potential unintended consequence described in the 2016 Proposal.

D. Alternatives Considered

The development of this rulemaking involved the consideration of a number of alternative approaches to address the problems described above. This section explains (i) why standard setting is preferable to other policy-making approaches, such as providing interpretive guidance or enhancing inspection or enforcement efforts; (ii) other standard-setting approaches that were considered; and (iii) key policy choices made by the Board in determining the details of the standard-setting approach in this rulemaking.

1. Why Standard Setting Is Preferable to Other Policy-Making Approaches

The Board's policy tools include alternatives to standard setting, such as issuing additional interpretive guidance or an increased focus on inspections or enforcement of existing standards. The Board considered whether providing guidance or increasing inspection or enforcement efforts would be effective corrective mechanisms to address concerns with the supervision of other auditors and the sources of information asymmetry discussed in Section IV.B above. The Board concluded that interpretive guidance, inspections, or enforcement actions alone would be less effective in achieving the Board's objectives than in combination with amending the auditing standards. Interpretive guidance inherently provides additional information about existing standards. Inspections and enforcement actions take place after insufficient audit performance (and potential investor harm) has occurred. Devoting additional

¹⁰³ See 2017 SRC at 40.

resources to guidance, inspections, and enforcement activities without improving the relevant performance requirements for auditors would, at best, focus auditors' performance on existing standards and would not gain the benefits associated with improving the standards. Two commenters expressed support for an approach that includes standard setting.¹⁰⁴ The Board's approach reflects its conclusion that standard setting is needed to fully achieve the benefits resulting from improvement in audits involving multiple auditors.

2. Other Standard-Setting Alternatives Considered

The Board also considered certain standard-setting approaches, including: (i) retaining the existing framework but requiring the lead auditor to disclose which standard (AS 1201 or AS 1205) governs the relationship between the lead auditor and other auditors; (ii) amending AS 1205 or extending the approach in that standard to cover all arrangements involving other auditors and referred-to auditors; (iii) developing a new standard, in addition to the Board's risk assessment standards, that would address all arrangements with other auditors and referred-to auditors; or (iv) amending existing standards to address the oversight of multi-location audit engagements generally (including multi-location engagements performed by a single firm), in addition to amending the standards to address the auditor's use of other auditors and referred-to auditors.

i. Disclosing Which Standard Applies Under Existing Framework

The Board considered but is not adopting a requirement that the lead auditor disclose, in the audit report or elsewhere, whether the lead auditor applied AS 1205 or AS 1201 in its oversight of the other auditor. Such a disclosure approach would not achieve the benefits of applying AS 1201 (as amended) to all audits that involve other auditors, and inconsistencies between firms in their approaches to the oversight of other auditors would remain.

From an economic perspective, it is more efficient and effective to address the reasons for change described above by amending existing auditing standards on supervision than by disclosing which standard applies. The amendments directly address the lead auditor's incentives, whereas disclosing which one of the standards (before the amendments) applies would do so indirectly at best. For disclosure to sufficiently change the lead auditor's incentives, investors would need to apply significant market pressure on auditors to improve their supervisory procedures beyond requirements in PCAOB standards (before the amendments). This approach seems unlikely given the wide dispersion of share ownership among investors and the costs of engaging in collective action.

¹⁰⁴ These commenters also suggested improving the practicability of proposed requirements by allowing the lead auditor to seek assistance from other auditors in supervising the audit to a greater extent than the Board proposed. In response to these and other comments, the Board made a number of changes in the 2021 SRC to address the practicability concern, including in connection with multi-tiered audits, as discussed in more detail in Appendix 4 of this release.

ii. Amending AS 1205

The Board considered, but is not adopting, two alternative approaches that would amend rather than rescind AS 1205. The first approach would have amended AS 1205 to strengthen its oversight requirements but otherwise retained the existing two-standard framework in which an engagement involving other auditors could be governed by either AS 1205 or AS 1201, depending on the circumstances of the engagement. The second approach would have amended AS 1205 to extend its application to all arrangements involving other auditors and referred-to auditors such that AS 1201 would no longer apply.

The Board determined that the risk-based supervision approach in AS 1201 promotes a more appropriate involvement by the lead auditor than the approach in AS 1205. The supervisory approach in AS 1201 requires that the level of supervision be commensurate with the associated risks, and that would apply to the supervision of the other auditors' work. From an economic perspective, the risk-based approach, which is now a well-established and understood auditing practice, requires the lead auditor to take into account the facts and circumstances of an audit engagement to inform a variety of resource allocation decisions, including the nature, timing, and extent of its supervision of other auditors. This approach enables the lead auditor to better align its supervisory effort with the level of risk, focusing more attention on the riskiest areas of the audit and thus provide more risk mitigation benefit to investors. Similarly, the other auditors' communication of important and relevant information to the lead auditor allows the lead auditor to make better-informed decisions regarding the work of the other auditor.

In contrast, AS 1205 employs an approach that allows the lead auditor to use the work of other auditors based on the performance of certain limited procedures that are not explicitly required to be tailored for the associated risks. Thus, the approach of AS 1205 would not address the problems described in this release as effectively as the supervisory approach of AS 1201.

iii. Developing a New Standard for All Arrangements with Other Auditors and Referred-to Auditors

The Board also considered developing a new, separate standard to govern all arrangements with other auditors and referred-to auditors. In that regard, some commenters suggested the PCAOB align a new standard with the relevant standards of other standard setters such as the IAASB. Although the IAASB has a separate standard for group audits, ISA 600, the Board believes that adopting a separate standard in its auditing standards is not necessary for most audits in which the lead auditor uses the work of other auditors. (The Board is, however, adopting a separate standard, AS 1206, to govern divided-responsibility audits, which are relatively uncommon.) Specifically, the existing standard on supervision, AS 1201, which is integrated with the Board's other risk assessment standards, already includes principles-based requirements that apply to audits involving other auditors in situations not covered by AS 1205.

Extending the requirements of AS 1201 to all situations involving other auditors and adding to AS 1201 more specific requirements for supervising the other auditor's work is a more efficient way to incorporate these requirements into the existing framework of PCAOB auditing standards. In addition, as discussed above, some commenters supported the Board's objective of establishing requirements for using other auditors' work that are risk-based and more closely aligned with the Board's risk assessment standards than existing standards. Accordingly, this rulemaking takes an integrated approach that involves enhancing the existing standard through targeted amendments that impose certain requirements on the lead auditor, rather than creating an entirely new standard.

iv. Amending to Address Oversight of Multi-location Engagements

The Board considered, but is not adopting, amendments to existing standards that would apply to oversight of multi-location audit engagements generally (including multi-location engagements performed by a single firm), in addition to amendments that apply to the auditor's use of other auditors and referred-to auditors. The Board is not adopting such amendments because existing PCAOB auditing standards already specifically address multi-location engagements.¹⁰⁵ Additional requirements for these audits, along with requirements for supervising other auditors, could create unnecessary complexity and redundancy with existing requirements. Finally, the Board through its oversight has seen less cause for concern regarding single-firm multi-location engagements compared to audits involving other auditors.

3. Key Policy Choices

Given a preference for amending AS 1201, the Board considered different approaches to addressing key policy issues.

i. Sufficiency of the Lead Auditor's Participation

To increase the likelihood that a lead auditor is meaningfully involved in the audit, the amendments require that the lead auditor determine the sufficiency of its participation in each audit that involves other auditors or referred-to auditors.¹⁰⁶ Sufficient participation by the lead auditor is required so that the work of all audit participants is properly planned and supervised, the results of the work are properly evaluated, and the lead auditor is in a position to conclude that the financial statements are presented fairly in all material respects. In evaluating the alternative approaches, the Board weighed the practical implications of specific criteria or

¹⁰⁵ Requirements for multi-location engagements are specifically addressed in risk assessment standards adopted by the Board in 2010 and in certain other standards. *See, e.g., AS 2101; AS 2105, Consideration of Materiality in Planning and Performing an Audit; AS 2110, Identifying and Assessing Risks of Material Misstatement; AS 2301. See also AS 2401, Consideration of Fraud in a Financial Statement Audit; Paragraphs A60–A67 of AS 1215, Appendix A: Background and Basis for Conclusions; AS 6115, Reporting on Whether a Previously Reported Material Weakness Continues to Exist.*

¹⁰⁶ *See paragraphs .06A–.06C of AS 2101.*

conditions on the efficiency and effectiveness of the audit. The Board also evaluated, among other things, relevant information from its oversight activities and views from Standing Advisory Group (SAG) members.¹⁰⁷

The requirement for determining sufficiency of participation which the Board is adopting is based on the following criteria: (i) the importance of the locations or business units for which the engagement partner's firm performs audit procedures in relation to the financial statements as a whole, considering quantitative and qualitative factors; (ii) the risks of material misstatement associated with the portion of the financial statements audited by the engagement partner's firm in comparison with the other auditors' or referred-to auditors' portions; and (iii) the extent of the engagement partner's firm's supervision of the other auditors' work. The second consideration is aligned with the principle of determining the scope of work in a multi-location audit, as both take into account the risk associated with the respective locations or business units. The first and third considerations cover specific situations that may arise in audits involving other auditors or referred-to auditors, where applicable; these considerations address concerns about the practicability of the proposed requirements that were expressed by some commenters on the 2016 Proposal, the 2017 SRC, and the 2021 SRC. (For a more detailed discussion of the required sufficiency-of-participation determination, including the Board's analysis of the comments received, see Appendix 4 of this release.)

The Board considered prescribing additional considerations for determining sufficiency of participation based on the location of the company's principal assets, principal operations, and corporate offices. Such additional considerations were not adopted because the considerations in the final amendments already encompass them to the extent they reflect the importance of the location or pose risks of material misstatement to be addressed in the audit. Moreover, as further discussed in Section III.A.1 of Appendix 4 of this release, the Board is concerned that adding more considerations could increase the risk that the firm issuing the auditor's report would not meaningfully participate in the audit, and thus would be the "lead auditor" in name only.

ii. Lead Auditor's Supervisory Requirements

When other auditors are involved in an audit, the Board considered whether the lead auditor (which includes the engagement partner and other supervisory personnel of the firm issuing the audit report) should be specifically required to perform certain supervisory procedures, and what the scope of any such procedures should be. PCAOB standards allow the engagement partner to seek assistance from appropriate engagement team members in

¹⁰⁷ See SAG Meeting Archive (May 18, 2016; Dec. 1, 2016; May 24, 2017; Nov. 30, 2017), available at <https://pcaobus.org/about/advisory-groups/archive-advisory/standing-advisory-group/sagmeetingarchive>. Transcripts of the relevant portions of SAG meetings related to this project are available in the docket for this rulemaking on the PCAOB's website (<https://pcaobus.org/Rulemaking/Pages/Docket042.aspx>).

fulfilling his or her supervisory responsibilities, but the standards for supervision (without the amendments) do not specify which supervisory procedures must be performed by the lead auditor.

In many audits, engagement partners seek assistance in fulfilling their supervisory responsibilities from engagement team members at other accounting firms that participate in the audit. By increasing the lead auditor's monitoring responsibilities, the supervisory procedures for the lead auditor that are described in the amendments should 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. Thus, these amendments aim to change auditor behavior by strengthening the incentives of the lead auditor and therefore addressing the information and incentive problems discussed in Section IV.B above.

The Board considered, but is not adopting, a requirement that the lead auditor obtain an understanding of the qualifications of all engagement team members outside the lead auditor's firm. Instead, the amended standards require that the lead auditor obtain an understanding of the knowledge, skill, and ability of the other auditor's engagement team members who assist the engagement partner with planning or supervision.¹⁰⁸ Further, in response to comments on the proposed requirements, the amendments provide that in audits involving multiple tiers of other auditors, the lead auditor may seek assistance from the first other auditor in performing this procedure with respect to the second other auditor.¹⁰⁹ The requirement the Board is adopting is designed to result in a more effective allocation of audit resources by focusing the lead auditor's efforts on the engagement team members outside the firm with whom the lead auditor primarily communicates and who are responsible for planning or supervising the work performed by other engagement team members.

The Board also considered, but is not adopting, a requirement that the lead auditor determine the nature, timing, and extent of audit procedures to be performed by the other auditors. Instead, the amended standards require that the lead auditor determine the scope of the work of other auditors and review the other auditors' written description of audit procedures to be performed pursuant to the scope of work requested. The amended standards also require that the lead auditor determine whether there are any changes necessary to the procedures and discuss the changes with, and communicate them in writing to, other auditors. This approach is more effective because the lead auditor generally has better visibility of the entire audit, and the other auditors generally have more detailed information than the lead auditor about audit areas in which they are involved.

¹⁰⁸ See AS 1015.06 and AS 2101.06Ha, according to which "[e]ngagement team members should be assigned to tasks and supervised commensurate with their level of knowledge, skill, and ability" This provision is discussed in more detail in Section III of Appendix 4 of this release.

¹⁰⁹ This provision is discussed in more detail in Section V of Appendix 4 of this release.

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.”¹¹⁰ 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.

The proposing releases sought comment, including any available empirical data, on how the proposed amendments to the auditing standards would affect EGCs, and whether they would protect investors and promote efficiency, competition, and capital formation.¹¹¹ Commenters generally supported applying the proposed requirements to audits of EGCs. One noted the increased risks associated with EGCs and that applying the amendments to EGC audits could help to address those risks. Others emphasized that consistent requirements should apply for similar situations encountered in any audit of a company, whether that company is an EGC or not. One commenter on the 2021 SRC agreed with the Board’s statements that the benefits to audit quality through improved planning and supervision may be especially significant for EGC audits, and that the amendments could contribute to an increase in the credibility of EGCs’ financial reporting.

To inform consideration of the application of auditing standards to audits of EGCs, PCAOB staff prepares a white paper annually that provides general information about characteristics of EGCs.¹¹² As of the November 15, 2020 measurement date, PCAOB staff

¹¹⁰ See Pub. L. No. 112-106 (Apr. 5, 2012). See Section 103(a)(3)(C) of Sarbanes-Oxley, 15 U.S.C. § 7213(a)(3)(C), as added by Section 104 of the JOBS Act also provides that any rules of the Board requiring (1) mandatory audit firm rotation or (2) a supplement to the auditor’s report in which the auditor would be required to provide additional information about the audit and the financial statements of the issuer (auditor discussion and analysis) shall not apply to an audit of an EGC. The amendments do not fall within either of these two categories.

¹¹¹ See 2016 Proposal at 51; 2017 SRC at 43; 2021 SRC at 66.

¹¹² For the most recent EGC report, see *Characteristics of Emerging Growth Companies and Their Audit Firms at November 15, 2020* (Jan. 24, 2022), available at https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/economicandriskanalysis/projectsother/documents/white-paper-on-characteristics-of-emerging-growth-companies-at-november-15-2020.pdf?sfvrsn=ee0e6910_3.

identified 1,940 companies that self-identified with the SEC as EGCs and filed audited financial statements in the 18 months preceding the measurement date.¹¹³

Analysis of Form AP filings in 2021 indicates that audits of EGCs are less likely to involve other accounting firms (i.e., other auditors and referred-to auditors) compared to the broader population of issuer audits. For example, as shown in Figure 6, only 14 percent of audits of EGCs involved other firms compared to 27 percent of issuer audits overall.¹¹⁴ Thus, because the use of other firms 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 amendments.

Figure 6. Comparison of the Use of Other Auditors in Audits of EGCs and Issuers Overall (2021)

	Audits of EGCs	Audits of issuers overall*
Percentage of issuer audits that use other auditors	14%	26%
Percentage of audits involving other auditors where:		
2 or more other auditors were involved	35%	61%
5 or more other auditors were involved	5%	28%
Percentage of audits involving other auditors where:		
Other auditors performed 10% or more of total audit hours	40%	52%
Other auditors performed 30% or more of total audit hours	17%	19%

Source: 2021 Form AP data obtained from PCAOB's AuditorSearch database.

Note: The term "other auditors" as used in this table includes referred-to auditors and refers only to other accounting firms and not individual accountants at those firms. See footnote 69 above.

¹¹³ See *id.* at 1. Approximately 97 percent of EGCs were audited by accounting firms that also audit issuers that are not EGCs, and 40 percent of EGC filers were audited by firms that were subject to inspection 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 16, 20. As of the November 15, 2021 measurement date, PCAOB staff identified approximately 3,100 companies that self-identified with the SEC as EGCs and filed audited financial statements in the 18 months preceding the measurement date. The increase from 2020 to 2021 is, in large part, driven by special purpose acquisition companies. Special purpose acquisition company audits rarely involve the participation of other auditors.

¹¹⁴ The analysis of Form AP data presented in Figure 6 is limited to issuers other than investment company vehicles and employee benefit plans.

Audits of EGCs that do involve other accounting firms are also likely to involve fewer other firms than those of issuers overall. For example, as shown in Figure 6, in audits involving other accounting firms, EGC audits involve two or more other firms in about 35 percent of audits compared to about 61 percent of audits of issuers overall. The difference is more pronounced when considering the use of several other firms, where only about five percent of EGC audits involving other firms involve five or more other firms in contrast to about 28 percent of issuer audits overall.

A comparison of the share of total audit hours performed by other accounting firms shows a more modest difference between EGC audits and issuer audits overall. Measured by the share of total audit hours performed by other accounting firms, the role of other firms on EGC audits is less substantial compared to their role on audits of issuers overall. For example, as shown in Figure 6, other accounting firms perform 10 percent or more of the audit hours in about 40 percent of audits of EGCs compared to about 52 percent of audits of issuers overall. Other accounting firms perform 30 percent or more of the audit hours in about 17 percent of audits of EGCs and about 19 percent of audits of issuers overall.

These statistics suggest that, when compared to issuer audits overall, audits of EGCs are less likely to involve the use of other firms and, even when they do, they typically involve fewer other firms and those other firms account for a smaller share of total audit hours.

For individual EGC audits involving other firms, the economic impacts of the amendments may be more or less significant depending on the facts and circumstances of a particular audit. In addition to the extent of involvement of other firms, the benefits and costs also depend on the level of risk associated with the audit work performed by other firms, the current methodologies, and the ability to distribute implementation costs across engagements. EGCs are likely to be newer companies, which may increase the importance to investors of the external audit to enhance the credibility of management disclosures.¹¹⁵ All else equal, the benefits of the higher audit quality resulting from the amendments may be larger for EGCs than for non-EGCs. In particular, because investors who face uncertainty about the reliability of a company's financial statements may require a larger risk premium that increases the cost of capital to companies, the improved audit quality resulting from applying the new amendments to EGC audits involving other firms could reduce the cost of capital to those EGCs.¹¹⁶ Moreover, because of the scalability of the risk-based requirements, the costs of performing the procedures are unlikely to be disproportionate to the benefits of the procedures. Overall, the

¹¹⁵ 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. 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. See 2021 SRC at 65 notes 181 and 182.

¹¹⁶ See 2021 SRC at 65 note 183.

amendments are expected to enhance audit quality and contribute to an increase in the credibility of financial reporting by EGCs.

For the reasons explained above, the Board believes that the amendments are in the public interest and, after considering the protection of investors and the promotion of efficiency, competition, and capital formation, recommends that the amendments should apply to audits of EGCs. Accordingly, the Board recommends 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. The Board stands ready to assist the Commission in considering any comments the Commission receives on these matters during the Commission's public comment process.

VI. APPLICATION TO AUDITS OF BROKERS AND DEALERS

The amendments, if approved by the SEC, will apply to audits of brokers and dealers as defined in Sections 110(3)-(4) of Sarbanes-Oxley.¹¹⁷ The proposing releases solicited comment on such applicability. No commenters opposed, and several commenters supported, applying the amendments to audits of brokers and dealers. In response to the 2021 SRC, one commenter said that it was not aware of any strong arguments that would indicate that the audits of brokers and dealers should be excluded from the application of the proposed amendments, and the commenter expressly supported applying the proposed amendments to audits of brokers and dealers. One commenter said that it did not believe that the revisions discussed in the 2021 SRC presented specific issues regarding audits of brokers and dealers.

As the Board noted in the 2016 Proposal, the auditing standards that currently govern the use of other auditors and referred-to auditors in audits of brokers and dealers are the same as those for audits of issuers. The application of the amendments to audits of brokers and dealers will continue this approach.

Staff analysis of PCAOB inspections data for audits of brokers and dealers indicates that there are no brokers or dealers that are currently issuers, although some of the largest brokers and dealers are subsidiaries of issuers. Information from PCAOB inspections and from annual

¹¹⁷ For attestation engagements in conjunction with Exchange Act Rule 17a-5, 17 C.F.R. § 240.17a-5, the supervision requirements of Attestation Standard No. 1, *Examination Engagements Regarding Compliance Reports of Brokers and Dealers*, or Attestation Standard No. 2, *Review Engagements Regarding Exemption Reports of Brokers and Dealers*, apply to the supervision of the work of other auditors. See *Standards for Attestation Engagements Related to Broker and Dealer Compliance or Exemption Reports Required by the U.S. Securities and Exchange Commission and Related Amendments to PCAOB Standards*, PCAOB Release No. 2013-007, at A4-30 (Oct. 10, 2013).

reports filed by registered firms indicates that other auditors played a substantial role¹¹⁸ in a small number of audits of brokers and dealers.¹¹⁹ Further, information obtained by PCAOB staff has not identified any audits of brokers and dealers in which the lead auditor divided responsibility for the audit with another accounting firm.

The Board's determination that the amendments will apply to audits of brokers and dealers is based on the observation that auditing plays a key role in enhancing the reliability of financial information provided by brokers and dealers, which is important to investor protection. The audit of brokers and dealers is intended to mitigate problems related to information asymmetry between customers of brokers and dealers, who use the services of brokers and dealers to invest in securities and other financial instruments, and management of brokers and dealers, who prepare financial information. This information asymmetry between customers and management of brokers and dealers may be significant. Customers of brokers and dealers are likely to be numerous, geographically distributed, and not expert in the management or operation of brokers and dealers. This information asymmetry makes the role of auditing important in enhancing the reliability of financial information. In addition, the audit of brokers and dealers may also help attenuate information asymmetry between management of brokers and dealers and other users of financial statements, such as counterparties and regulatory authorities.

The amendments are not expected to have a widespread impact on the audits of brokers and dealers that are not subsidiaries of issuers, since there are likely few instances in which such audits involve the use of other auditors. However, in those instances in which other auditors are used, the expected improvements in audit quality described in Section IV.C.1 above will benefit the customers of the broker or dealer, along with investors and the capital markets. Because of the scalability of the risk-based requirements, the costs of performing the procedures are unlikely to be disproportionate to the benefits of the procedures.

¹¹⁸ See PCAOB Rule 1001(p)(ii) (defining the phrase "play a substantial role in the preparation or furnishing of an audit report").

¹¹⁹ Firms that conduct non-issuer audits in accordance with PCAOB standards, including audits of brokers and dealers reporting under Exchange Act Rule 17a-5, are not required to file a report on Form AP regarding such audits. See *Staff Guidance: Form AP, Auditor Reporting of Certain Audit Participants, and Related Voluntary Audit Report Disclosure Under AS 3101, The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion* (Dec. 17, 2021), at 3. Thus, unlike in the case of audits of issuers (including EGCs), Form AP data on the extent of use of other auditors and referred-to auditors in audits of brokers and dealers is not available.

VII. EFFECTIVE DATE

The Board has determined that the amendments will take effect, subject to approval by the SEC, for audits of financial statements for fiscal years ending on or after December 15, 2024.

In the proposing releases, the Board sought comment on the amount of time auditors would need before the proposed amendments would become effective, if adopted by the Board and approved by the SEC. A number of commenters on the 2021 SRC recommended that the Board provide an effective date at least two years after Board adoption and SEC approval. Some preferred, if SEC approval were to occur in the last half or quarter of the year, an effective date at least three years afterwards. In support of the time needed before effectiveness, commenters offered that audit firms will need enough time to implement the amended standards throughout the firm (such as through methodology, tools, guidance, quality control system changes, and training) and to discuss and coordinate implications of the amendments with other auditors and referred-to auditors. Some commenters also stated that because the amendments relate to matters that occur at the beginning of the audit, the implementation needs to occur before the beginning of the fiscal year of the financial statements to be audited.

The Board recognizes the preferences expressed by commenters. It also appreciates the efforts already undertaken by many audit firms to raise their standards of practice in advance of the adoption of these amendments. The effective date the Board is adopting is designed to provide all auditors with a reasonable period of time to implement the amendments, without unduly delaying the intended benefits resulting from these improvements to PCAOB standards.¹²⁰

* * *

¹²⁰ See *Auditing Accounting Estimates, Including Fair Value Measurements and Amendments to PCAOB Auditing Standards*, PCAOB Release No. 2018-005 (Dec. 20, 2018) (providing an effective date approximately one year after PCAOB adoption); *Amendments to Auditing Standards for Auditor's Use of the Work of Specialists*, PCAOB Release No. 2018-006 (Dec. 20, 2018) (same).

On the 21st day of June, in the year 2022, the foregoing was, in accordance with the bylaws of the Public Company Accounting Oversight Board,

ADOPTED BY THE BOARD.

A handwritten signature in blue ink, appearing to read "PWB", with a long horizontal flourish extending to the right.

Phoebe W. Brown
Secretary

June 21, 2022

APPENDIX 1

Amendments to PCAOB Auditing Standards Relating to the Planning and Supervision of Audits Involving Other Auditors

The Board is adopting amendments to certain PCAOB auditing standards related to the planning and supervision of audits involving other auditors, and this appendix sets forth those amendments. The table below is a reference tool for the amendments.

PCAOB Standard	Title	Paragraphs Amended
AS 1015	Due Professional Care in the Performance of Work	.01, .06
AS 1105	Audit Evidence	.B1, .B2
AS 1201	Supervision of the Audit Engagement	.01, .03–.05, .07–.15 (new), .A1, .A2 (deleted)
AS 1215	Audit Documentation	.03, .18, .19
AS 1220	Engagement Quality Review	.02, .10
AS 2101	Audit Planning	.03, .04, .06, .06A–.06I (new), .07, .09–.11, heading after .13 (new), .14, .16, .A1, .A3–.A6 (new)

Note: The amended paragraphs referenced above include revisions to the accompanying footnotes.

Amendments to AS 1015

- I. AS 1015 is amended by adding a note to paragraph .01 to read as follows:

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 meaning as defined in Appendix A of AS 2101.

- II. AS 1015 is amended by adding footnote 3 and revising footnote 4 to paragraph .06 to read as follows:

.06 Engagement team³ 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

³ The term “engagement team,” as used in this standard, has the same meaning as defined in Appendix A of AS 2101.

⁴ See AS 1201.

Amendments to AS 1105

- III. AS 1105 is amended by revising paragraph .B1 to read as follows:

.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 the investee’s auditor is satisfactory for this purpose, the auditor may consider performing procedures such as making inquiries as to the professional reputation, standing, and independence of the investee’s auditor (under the applicable standards), visiting the investee’s auditor and discussing the audit procedures followed and the results thereof, and reviewing the audit program and/or working papers of the investee’s auditor.

IV. AS 1105 is amended by revising paragraph .B2 to read as follows:

.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.

Amendments to AS 1201

V. AS 1201 is amended by adding footnote 1 to paragraph .01 as follows:

.01 This standard establishes requirements regarding supervision of the audit engagement, including supervising the work of engagement team¹ 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*.

VI. AS 1201 is amended by revising paragraph .03 to read as follows:

.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 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}

^{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 meaning as defined in Appendix A of AS 2101.

VII. AS 1201 is amended by revising paragraph .04 to read as follows:

.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.

VIII. AS 1201 is amended by revising footnote 9 of paragraph .05 to read as follows:

⁹ See, e.g., AS 2101.15, AS 2110.74, and paragraphs .20–.23 and .35–.36 of AS 2810, *Evaluating Audit Results*.

- IX.** AS 1201 is amended by adding, after paragraph .06, a new heading and new paragraphs .07–.13:

Procedures to Be Performed by the Lead Auditor with Respect to the Supervision of Work Performed by Other Auditors¹⁴

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 associated with 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. See also requirements in AS 2110.59 regarding the auditor’s responsibility to identify and assess the risks of material misstatement at the financial statement level and assertion level.

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 the other auditor 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 auditor, 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.

- X.** AS 1201 is amended by adding, after new paragraph .13, a new heading and new paragraphs .14–.15:

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.

XI. AS 1201, Appendix A, is amended to read, in its entirety, as follows:

Appendix A – Definitions

.A1 For purposes of this standard:

- a. The term “engagement partner” 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*.

Amendments to AS 1215

XII. AS 1215 is amended by adding footnote 1A to paragraph .03 to read as follows:

.03 Audit documentation is reviewed by members of the engagement team^{1A} performing the work and might be reviewed by others. Reviewers might include, for example:

^{1A} The term “engagement team,” as used in this standard for audit engagements, has the same meaning as defined in Appendix A of AS 2101, *Audit Planning*. As used in this standard for review and attestation engagements, the term has a meaning analogous to the term’s definition in AS 2101 for audit engagements.

XIII. AS 1215 is amended by revising paragraph .18 to read as follows:

.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 auditor,” as used in this standard, has the same meaning as defined in Appendix A of AS 2101.

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. Compliance with this standard does not substitute for compliance with Section 106(b) or any other applicable law.

XIV. AS 1215 is amended by revising paragraph .19 to read as follows:

.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 offices of the firm and 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 other 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.

^{4A} For multi-tiered audits, see note to paragraph .14 of AS 1201, *Supervision of the Audit Engagement*.

Amendments to AS 1220

XV. AS 1220 is amended by adding footnote 1A to paragraph .02 to read as follows:

.02 The objective of the engagement quality reviewer is to perform an evaluation of the significant judgments made by the engagement team^{1A} and the related conclusions reached in forming the overall conclusion on the engagement and in preparing the engagement report, if a report is to be issued, in order to determine whether to provide concurring approval of issuance.¹

^{1A} The term “engagement team,” as used in this standard for audit engagements, has the same meaning as defined in Appendix A of AS 2101, *Audit Planning*. As used in this standard for review and attestation engagements, the term has a meaning analogous to the term’s definition in AS 2101 for audit engagements.

XVI. AS 1220 is amended by adding a bullet at the end of paragraph .10a to read as follows:

.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,
 - 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 meaning as defined in Appendix A of AS 2101. AS 2101.06A–.06C 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.

Amendments to AS 2101

XVII. AS 2101 is amended by setting the term "engagement team" in boldface type in paragraph .03 and revising paragraph .03 to read as follows:

.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.

XVIII. AS 2101 is amended by revising paragraph .04 to read as follows:

.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 auditors** or **referred-to auditors**, 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).

XIX. AS 2101 is amended by revising paragraph .06b to read as follows:

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

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.

^{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–.06F 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.

XX. AS 2101 is amended by adding, after paragraph .06, a new heading:

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

XXI. AS 2101 is amended by adding new subheadings and new paragraphs .06A–.06I:

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. See also AS 1201.07, which states that for engagements that involve other auditors, AS 1201.08–.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 AS 1201.

.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 or description, 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) of 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.

XXII. AS 2101 is amended by revising footnote 6 to paragraph .07 to read as follows:

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)(B) and 7201(3)(B).

XXIII. AS 2101 is amended by revising footnotes 8, 9, and 10 to paragraph .09 to read as follows:

⁸ *See, e.g.*, 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 how to determine 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 *See* paragraphs .06–.06I of this standard.

¹⁰ *See, e.g.*, AS 1015.06, paragraph .16 of this standard, and AS 2301.05a.

XXIV. AS 2101 is amended by revising footnote 12 to paragraph .10 to read as follows:

¹² AS 2301 and AS 2201.

XXV. AS 2101 is amended by deleting footnote 13 to paragraph .11, which will read as follows:

^[13] [Footnote deleted.]

XXVI. AS 2101 is amended by adding a new heading after paragraph .13 to read as follows:

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

XXVII. AS 2101 is amended by revising paragraph .14, including the deletion of footnote 18, to read as follows:

.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.

[¹⁸] [Footnote deleted.]

XXVIII. AS 2101 is amended by revising paragraph .16 to read as follows:

.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.

XXIX. AS 2101, Appendix A, is amended by revising the title to read as follows:

Appendix A – Definitions

XXX. AS 2101, Appendix A, is amended by revising paragraph .A1 to read as follows:

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

XXXI. AS 2101, Appendix A, is amended by adding, after paragraph .A2, new paragraphs .A3–.A6:

.A3 Engagement team –

a. Engagement team includes:

- (1) Partners, principals, and shareholders of, and accountants¹ 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, in connection with the audit, (i) are employed by the lead auditor or an other auditor participating in the audit and (ii) assist that auditor 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) of 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 firm³ 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 secondees⁵ 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) of 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 an individual participating in a secondment arrangement in which, for at least three consecutive months, (1) a professional employee of an accounting firm in one country works for a registered public accounting firm that is located in another country and is issuing an auditor's report, and (2) the professional employee performs audit procedures with respect to entities and their operations in that other country and does not perform more than de minimis audit procedures in relation to entities or business operations in the country of his or her employer. A secondee can be either physically located in that other country or working through a remote work arrangement.

.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 units⁶ 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.

APPENDIX 2

The Board is adopting new auditing standard AS 1206. The text of this standard is set forth below.

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

Introduction

.01 This standard establishes requirements for the lead auditor¹ regarding dividing responsibility for the audit of the company's financial statements² and, if applicable, internal control over financial reporting³ with a referred-to auditor.⁴

Note: AS 2101 establishes requirements regarding serving as the lead auditor.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–.09 of this standard in relation to each of the referred-to auditors 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.⁶

¹ The term "lead auditor," as used in this standard, has the same meaning as defined in Appendix A 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–.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.

⁴ The term "referred-to auditor," as used in this standard, has the same meaning as defined in Appendix A of AS 2101.

⁵ See paragraphs .06A–.06C of AS 2101.

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

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 units⁷ audited by the referred-to auditor into the company's financial statements.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 Securities and Exchange Commission ("SEC"); and
- 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 the audit and issued the auditor's report in accordance with the standards of the PCAOB,⁹

⁷ The term "business units" includes subsidiaries, divisions, branches, components, or investments.

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.

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*

- b. The lead auditor determines, based on inquiries made of the referred-to auditor and other information obtained by the lead auditor during the audit, that the referred-to auditor 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 is registered with the PCAOB if (1) it played a substantial role in the preparation or furnishing of the lead auditor's report or (2) the referred-to auditor's report is with respect to a business unit that is itself an issuer, broker, or dealer;¹⁰ and
- d. In situations when the financial statements of the company's business unit audited by the referred-to auditor 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) 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 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

Circumstances, apply to auditors' reports issued 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 applies to auditors' reports issued for audits of management's assessment of the effectiveness of internal control over financial reporting that are 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 (*see* AS 3101.06 and .09g, and AS 2201.85A and .85Dd) do not apply to a referred-to auditor's report. 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.

¹⁰ See PCAOB Rule 2100, *Registration Requirements for Public Accounting Firms*, and paragraph (p)(ii) of 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."

statements and, if applicable, internal control over financial reporting; or

Note: The lead auditor should state the reasons for 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.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 (or reports, if the lead auditor chooses to issue separate reports on the company's financial statements and on internal control over financial reporting) should:

- a. Indicate clearly, in the Opinion on the Financial Statements and, if applicable, Internal Control over Financial Reporting 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 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;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, or 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.

¹¹ 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.

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.

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.¹³

.09 If the report of the referred-to auditor includes an opinion other than 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 unqualified opinion and its disposition, or to the explanatory language, or to both, unless the matter is clearly trivial to the company's financial statements.

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 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.

Appendix A – Definitions

.A1 For purposes of this standard, the terms “engagement team,” “lead auditor,” and “referred-to auditor” have the same meaning as defined in Appendix A of AS 2101, *Audit Planning*.

Appendix 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 Chooses¹ 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

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, 20X2 and 20X1, and the related 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”). We also have audited 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).”*].

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. 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 as of December 31, 20X2, based on [*Identify control criteria, for example, “criteria established in Internal Control—Integrated Framework: 20XX issued by COSO.”*].

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.

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, 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 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.²

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 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 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. 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

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.)

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 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.

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.

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 Statements³

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 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

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.)

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 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]

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.)

Examples of an Alternative 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 3: Conversion Adjustments Audited by the Lead Auditor

We did not audit the financial statements of B Company, a wholly-owned subsidiary. The financial statements of B Company prepared under [*financial reporting framework used by B Company*] 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 under [*financial reporting framework used by B Company*], 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, 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. 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 4: Conversion Adjustments Audited by the Referred-to Auditor

We did not audit the financial statements of B Company, a wholly-owned subsidiary. The financial statements of B Company prepared under [*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 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 under accounting principles generally accepted in the United States of America, 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, 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.

APPENDIX 3

Other Related Amendments to PCAOB Auditing Standards

In connection with the amendments to PCAOB auditing standards adopted by the Board in this release, the Board is adopting conforming amendments to its auditing standards, auditing interpretations, attestation standards, rules, and Form AP, and this appendix sets forth those amendments. The table below is a reference tool for these conforming amendments.

PCAOB Standard, Auditing Interpretation, Rule, or Form AP	Title	Paragraphs Amended
AS 1205	Part of the Audit Performed by Other Independent Auditors	Rescinded
AS 1210	Using the Work of an Auditor-Engaged Specialist	.03
AS 1301	Communications with Audit Committees	.10e, .15
AS 2110	Identifying and Assessing Risks of Material Misstatement	.05e, .11A (new), .13, .64
AS 2201	An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements	.09, .B23, .C1, .C8, .C9 (deleted), .C10, .C11
AS 2301	The Auditor's Responses to the Risks of Material Misstatement	.05a
AS 2401	Consideration of Fraud in a Financial Statement Audit	.53, .61
AS 2410	Related Parties	.03, subheading before .08, .09, .16
AS 2601	Consideration of an Entity's Use of a Service Organization	.01, .18, .19
AS 2605	Consideration of the Internal Audit Function	.19

PCAOB Standard, Auditing Interpretation, Rule, or Form AP	Title	Paragraphs Amended
AS 2610	Initial Audits-Communications Between Predecessor and Successor Auditors	.12, .16
AS 2710	Other Information in Documents Containing Audited Financial Statements	.04
AS 2810	Evaluating Audit Results	.29
AS 3101	The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion	.12e, .18
AS 3105	Departures from Unqualified Opinions and Other Reporting Circumstances	.55
AS 3305	Special Reports	.31
AS 4105	Reviews of Interim Financial Information	.18b, .39, .40, .52
AS 6115	Reporting on Whether a Previously Reported Material Weakness Continues to Exist	.24, heading before paragraph .40, .40
AI 10	Part of the Audit Performed by Other Independent Auditors: Auditing Interpretations of AS 1205	Rescinded
AI 28	Evidential Matter Relating to Income Tax Accruals: Auditing Interpretations	.12
AT 1	Examination Engagements Regarding Compliance Reports of Brokers and Dealers	.06
AT 2	Review Engagements Regarding Exemption Reports of Brokers and Dealers	.05
AT 101	Attest Engagements	.103

PCAOB Standard, Auditing Interpretation, Rule, or Form AP	Title	Paragraphs Amended
Rule 1001	Definitions of Terms Employed in Rules	(p)(ii)
Rule 3211	Auditor Reporting of Certain Audit Participants	Note 1 to paragraph (a)
Form AP	Auditor Reporting of Certain Audit Participants	Note 1 to General Instruction 3, Item 3.2, Item 3.3, Item 5.1

Note: The amended paragraphs referenced above include revisions to the accompanying footnotes.

Rescission of AS 1205

- I. AS 1205 is rescinded.

Amendment to AS 1210

- II. AS 1210 is amended by adding footnote 1A to paragraph .03 to read as follows:

.03 The engagement partner and, as applicable, other engagement team^{1A} members performing supervisory activities¹ should assess the specialist's knowledge, skill, and ability in the particular field for the type of work under consideration. This includes obtaining an understanding of the following with respect to the specialist and the entity that employs the specialist:

^{1A} The term "engagement team," as used in this standard, has the same meaning as defined in Appendix A of AS 2101, *Audit Planning*.

Amendments to AS 1301

III. AS 1301 is amended by revising paragraph .10e and footnotes 12 and 13 to paragraph .10 to read as follows:

.10 As part of communicating the overall audit strategy, the auditor should communicate the following matters to the audit committee, if applicable:

- e. In an audit that involves other auditors or referred-to auditors, the basis for the engagement partner's determination that the participation of his or her firm is sufficient to serve as 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 in multi-location engagements.

¹³ The terms "lead auditor," "other auditor," and "referred-to auditor," as used in this standard, have the same meaning as defined in Appendix A of AS 2101. See AS 2101.06A–.06C, which establish requirements regarding serving as the lead auditor.

IV. AS 1301 is amended by adding footnote 27A to paragraph .15 to read as follows:

.15 The auditor should communicate to the audit committee matters that are difficult or contentious for which the auditor consulted outside the engagement team^{27A} and that the auditor reasonably determined are relevant to the audit committee's oversight of the financial reporting process.

^{27A} The term "engagement team," as used in this standard, has the same meaning as defined in Appendix A of AS 2101.

Amendments to AS 2110

V. AS 2110 is amended by adding footnote 4A to paragraph .05e to read as follows:

- e. Conducting a discussion among engagement team^{4A} members regarding the risks of material misstatement (paragraphs .49–.53); and

^{4A} The term “engagement team,” as used in this standard, has the same meaning as defined in Appendix A of AS 2101, *Audit Planning*.

VI. AS 2110 is amended by inserting new paragraph .11A after paragraph .11:

.11A If the auditor serves as a referred-to auditor in a divided-responsibility audit,^{7A} as part of obtaining an understanding of the company, the referred-to auditor should consider making inquiries of the lead auditor as to matters that may be significant to the referred-to auditor’s own audit. Such matters may include transactions, adjustments, or other matters that have come to the attention of the lead auditor and that may require adjustment to or disclosure in the financial statements audited by the referred-to auditor.

^{7A} See AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*.

VII. AS 2110 is amended by changing the footnote reference in paragraph .13 from 7A to 7B:

^{7B} See AS 2401.66–.67A.

VIII. AS 2110 is amended by revising footnote 26 to paragraph .45 to read as follows:

²⁶ Paragraph .07 of AS 2101.

IX. AS 2110 is amended by adding a new footnote 35A to the end of paragraph .64:

^{35A} See also AS 2101.11–.12, which describe additional risk assessment considerations for multi-location engagements.

Amendments to AS 2201

X. AS 2201 is amended by adding footnote 7A to paragraph .09 to read as follows:

.09 The auditor should properly plan the audit of internal control over financial reporting and properly supervise the engagement team^{7A} members. When planning an integrated audit, 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 –

^{7A} The term “engagement team,” as used in this standard, has the same meaning as defined in Appendix A of AS 2101, *Audit Planning*.

XI. AS 2201 is amended by revising paragraph .B23 to read as follows:

.B23 In determining whether the service auditor's report provides sufficient evidence to support the auditor's opinion, the auditor should make inquiries concerning the service auditor's reputation, competence, and independence. Appropriate sources of information concerning the professional reputation of the service auditor may include professional organizations and other relevant parties.

XII. AS 2201 is amended by revising subparagraph (c) of paragraph .C1 to read as follows:

- c. The auditor decides to refer to the report of another public accounting firm as the basis, in part, for the auditor's own report,

XIII. AS 2201 is amended by revising paragraph .C8 to read as follows:

.C8 *Opinions Based, in Part, on the Report of Another Public Accounting Firm.* Because an audit of the financial statements must be performed to audit internal control over financial reporting, only the lead auditor of the financial statements can be the lead auditor of internal control over financial reporting. In an audit that involves other auditors or referred-to auditors, the lead auditor of the consolidated 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. AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*, establishes requirements for situations in which the lead auditor of the consolidated financial statements and, if applicable, internal control over financial

reporting makes reference in the auditor's report to the report of another public accounting firm on the financial statements and, if applicable, internal control over financial reporting of one or more of the company's business units. See Appendix A of AS 2101, *Audit Planning*, for the definitions of "lead auditor," "other auditor," and "referred-to auditor." See also AS 2101.06A–.06C, which establish requirements regarding serving as the lead auditor.

XIV. AS 2201 is amended by deleting paragraph .C9 and inserting the following language:

[.C9] [Paragraph deleted.]

XV. AS 2201 is amended by revising paragraph .C10 to read as follows:

.C10 The lead auditor's decision about making reference to the referred-to auditor in the 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. For example, the audit report on the financial statements may make reference to the audit of a significant equity investment performed by the referred-to auditor, but the report on internal control over financial reporting might not make a similar reference because management's assessment of internal control over financial reporting ordinarily would not extend to controls at the equity method investee.¹

¹ See paragraph .B15, for further discussion of the evaluation of the controls over financial reporting for an equity method investment.

XVI. AS 2201 is amended by revising paragraph .C11 to read as follows:

.C11 When the lead auditor makes reference to the report of the referred-to auditor as a basis, in part, for the lead auditor's opinion on the company's internal control over financial reporting, the lead auditor should refer to the report of the referred-to auditor as discussed in AS 1206.

Amendment to AS 2301

XVII. AS 2301 is amended by adding footnote 1A to paragraph .05a to read as follows:

- a. *Making appropriate assignments of significant engagement responsibilities.* The knowledge, skill, and ability of engagement team^{1A} members with significant

engagement responsibilities should be commensurate with the assessed risks of material misstatement.¹

^{1A} The term “engagement team,” as used in this standard, has the same meaning as defined in Appendix A of AS 2101, *Audit Planning*.

Amendments to AS 2401

XVIII. AS 2401 is amended by revising the sixth bullet of paragraph .53 to read as follows:

- If other auditors or referred-to auditors^{20A} are auditing the financial statements of one or more of the company’s locations or business units,^{20B} where applicable, discussing with them the extent of work that needs to be performed to address the fraud risk resulting from transactions and activities relating to these locations or business units.

^{20A} The terms “other auditor” and “referred-to auditor,” as used in this standard, have the same meaning as defined in Appendix A of AS 2101, *Audit Planning*.

^{20B} The term “business units” includes subsidiaries, divisions, branches, components, or investments.

XIX. AS 2401 is amended by revising the fifth bullet of paragraph .61 to read as follows:

- *The nature and complexity of the accounts.* Inappropriate journal entries or adjustments may be applied to accounts that (a) contain transactions that are complex or unusual in nature, (b) contain significant estimates and period-end adjustments, (c) have been prone to errors in the past, (d) have not been reconciled on a timely basis or contain unreconciled differences, (e) contain intercompany transactions, or (f) are otherwise associated with an identified fraud risk. The auditor should recognize, however, that inappropriate journal entries and adjustments also might be made to other accounts. In audits of entities that have multiple locations or business units, the auditor should determine whether to select journal entries from locations or business units based on factors set forth in AS 2101.11–.14.

Amendments to AS 2410

XX. AS 2410 is amended by revising subparagraph (c) of paragraph .03 to read as follows:

- c. Communicating with the engagement team and referred-to auditors (paragraphs .08–.09).^{2A}

^{2A} The terms “engagement team” and “referred-to auditor,” as used in this standard, have the same meaning as defined in Appendix A of AS 2101, *Audit Planning*.

XXI. AS 2410 is amended by revising the subheading before paragraph .08 to read as follows:

Communicating with the Engagement Team and Referred-to Auditors

XXII. AS 2410 is amended by revising paragraph .09 to read as follows:

.09 If the auditor serves as the lead auditor and divides responsibility for the audit with a referred-to auditor, the lead auditor should communicate to the referred-to auditor relevant information about related parties, including the names of the company’s related parties and the nature of the company’s relationships and transactions with those related parties.⁹ The lead auditor also should inquire of the referred-to auditor regarding the referred-to auditor’s knowledge of any related parties or relationships or transactions with related parties that were not included in the auditor’s communications.

⁹ 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–.06C, which establish requirements regarding serving as the lead auditor. See also AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*, which establishes requirements for the lead auditor regarding dividing responsibility for the audit with a referred-to auditor.

XXIII. AS 2410 is amended by revising subparagraph (c) of paragraph .16 to read as follows:

- c. Promptly communicate to appropriate members of the engagement team and the referred-to auditor relevant information about the related party or relationship or transaction with the related party;

Amendments to AS 2601

XXIV. AS 2601 is amended by revising paragraph .01 to read as follows:

.01 This section provides guidance on the factors an independent auditor should consider when auditing the financial statements of an entity that uses a service organization to process certain transactions. This section also provides guidance for independent auditors who issue reports on the processing of transactions by a service organization for use by another auditor.

Note: When performing an integrated audit of financial statements and internal control over financial reporting, refer to paragraphs .B17–.B27 of Appendix B, *Special Topics*, of AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, regarding the use of service organizations.

XXV. AS 2601 is amended by revising paragraph .18 to read as follows:

.18 In considering whether the service auditor’s report is satisfactory for his or her purposes, the user auditor should make inquiries concerning the service auditor’s professional reputation. Appropriate sources of information concerning the professional reputation of the service auditor may include professional organizations and other relevant parties.

XXVI. AS 2601 is amended by revising paragraph .19 to read as follows:

.19 In considering whether the service auditor’s report is sufficient to meet his or her objectives, the user auditor should consider performing one or more of the following procedures:

- Visiting the service auditor and discussing the audit procedures followed and the results thereof.
- Reviewing the audit programs of the service auditor. In some cases, it may be appropriate to issue instructions to the service auditor as to the scope of the audit work.
- Reviewing additional audit documentation of the service auditor.

If the user auditor believes that the service auditor’s report may not be sufficient to meet his or her objectives, the user auditor may supplement his or her understanding of the service auditor’s procedures and conclusions by discussing with the service auditor the scope and results of the service auditor’s work. Also, if the user auditor believes it is necessary, he or she may contact the service organization, through the user organization, to request that the service

auditor perform agreed-upon procedures at the service organization, or the user auditor may perform such procedures.

Amendment to AS 2605

XXVII. AS 2605 is amended by revising paragraph .19 to read as follows:

.19 The responsibility to report on the financial statements rests solely with the auditor. Unlike the situation in which the auditor divides responsibility for the audit with another public accounting firm,⁶ this responsibility cannot be shared with the internal auditors. Because the auditor has the ultimate responsibility to express an opinion on the financial statements, judgments about assessments of inherent and control risks, the materiality of misstatements, the sufficiency of tests performed, the evaluation of significant accounting estimates, and other matters affecting the auditor's report should always be those of the auditor.

⁶ See AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*.

Amendments to AS 2610

XXVIII. AS 2610 is amended by revising footnote 8 to paragraph .12 to read as follows:

⁸ The successor auditor may wish to make inquiries about the professional reputation and standing of the predecessor auditor to one or more professional organizations or other relevant parties.

XXIX. AS 2610 is amended by revising paragraph .16 to read as follows:

.16 The successor auditor should plan and perform the reaudit in accordance with the standards of the PCAOB. The successor auditor should not assume responsibility for the predecessor auditor's work or divide responsibility for the reaudit with the predecessor auditor, as described in AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*. Furthermore, the predecessor auditor is not an auditor's specialist, nor does the predecessor auditor's work constitute the work of others as described in AS 2605, *Consideration of the Internal Audit Function*, or paragraphs .16–.19 of AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.

Amendment to AS 2710

XXX. AS 2710 is amended by revising footnote 2 to paragraph .04 to read as follows:

² In fulfilling his responsibility under this section, a lead auditor may also request the other auditor or referred-to auditor to read the other information. If a predecessor auditor's report appears in a document to which this section applies, he should read the other information for the reasons described in this paragraph. (See Appendix A of AS 2101, *Audit Planning*, for the definitions of "lead auditor," "other auditor," and "referred-to auditor.")

Amendment to AS 2810

XXXI. AS 2810 is amended by adding footnote 17A to paragraph .29 to read as follows:

.29 As part of this evaluation, the engagement partner should determine whether there has been appropriate communication with the other engagement team^{17A} members throughout the audit regarding information or conditions that are indicative of fraud risks.

^{17A} The term "engagement team," as used in this standard, has the same meaning as defined in Appendix A of AS 2101, *Audit Planning*.

Amendments to AS 3101

XXXII. AS 3101 is amended by adding footnote 20A to paragraph .12e to read as follows:

- e. The nature and extent of audit effort required to address the matter, including the extent of specialized skill or knowledge needed or the nature of consultations outside the engagement team^{20A} regarding the matter; and

^{20A} The term "engagement team," as used in this standard, has the same meaning as defined in Appendix A of AS 2101, *Audit Planning*.

XXXIII. AS 3101 is amended by revising subparagraph (b) of paragraph .18 to read as follows:

- b. The auditor divides responsibility with, and makes reference in the auditor's report to the audit and report of, another public accounting firm;²⁴

²⁴ AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*, establishes requirements for situations in which the auditor of the consolidated financial statements (the “lead auditor,” as defined in Appendix A to AS 2101) makes reference in the auditor’s report to the report of another public accounting firm that audited the financial statements of one or more of the company’s business units (the “referred-to auditor,” as defined in Appendix A to AS 2101). (See also paragraphs .06A–.06C of AS 2101, which establish requirements regarding serving as the lead auditor.)

Amendment to AS 3105

XXXIV. AS 3105 is amended by revising paragraph .55 to read as follows

.55 Before reissuing (or consenting to the reuse of) a report previously issued on the financial statements of a prior period, when those financial statements are to be presented on a comparative basis with audited financial statements of a subsequent period, a predecessor auditor should consider whether his or her previous report on those statements is still appropriate. Either the current form or manner of presentation of the financial statements of the prior period or one or more subsequent events might make a predecessor auditor’s previous report inappropriate. Consequently, a predecessor auditor should (a) read the financial statements of the current period, (b) compare the prior-period financial statements that he or she reported on with the financial statements to be presented for comparative purposes, and (c) obtain representation letters from management of the former client and from the successor auditor. The representation letter from management of the former client should state (a) whether any information has come to management’s attention that would cause them to believe that any of the previous representations should be modified, and (b) whether any events have occurred subsequent to the balance-sheet date of the latest prior-period financial statements reported on by the predecessor auditor that would require adjustment to or disclosure in those financial statements.¹⁷ The representation letter from the successor auditor should state whether the successor’s audit revealed any matters that, in the successor’s opinion, might have a material effect on, or require disclosure in, the financial statements reported on by the predecessor auditor. Also, the predecessor auditor may wish to consider (a) making inquiries about the professional reputation and standing of the successor auditor,^{17A} (b) obtaining a representation from the successor auditor that he or she is independent under the requirements of the PCAOB and the Securities and Exchange Commission, and (c) making inquiries of the successor auditor to determine that the successor auditor knows the relevant requirements of the applicable financial reporting framework, standards of the PCAOB, and financial reporting requirements of the Securities and Exchange Commission. However, the predecessor auditor should not refer in his or her reissued report to the report or work of the successor auditor.

¹⁷ See AS 2805, *Management Representations*, Appendix C [paragraph .18], “Illustrative Updating Management Representation Letter.”

^{17A} Inquiries may be made to one or more professional organizations or other relevant parties.

Amendment to AS 3305

XXXV. AS 3305 is amended by revising subparagraph (c) of paragraph .31 to read as follows:

- c. *Referred-to Auditors.* When the auditor divides responsibility for the audit with another public accounting firm, the auditor's report should make reference to the audit and report of the referred-to auditor in compliance with the requirements of paragraphs .08–.09 of AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*.⁴⁰

⁴⁰ AS 1206 establishes requirements for situations in which the auditor of the consolidated financial statements (the "lead auditor," as defined in Appendix A of AS 2101, *Audit Planning*) makes reference in the auditor's report to the report of another public accounting firm that audited the financial statements of one or more of the company's business units (the "referred-to auditor," as defined in Appendix A of AS 2101). (*See also* paragraphs .06A–.06C of AS 2101, which establish requirements regarding serving as the lead auditor.)

Amendments to AS 4105

XXXVI. AS 4105 is amended by revising paragraph .18b to read as follows:

- b. Obtaining reports from other accountants, if any, who have been engaged to perform a review of the interim financial information of significant components of the reporting entity or its other business units, or inquiring of those accountants if reports have not been issued.¹¹

¹¹ In these circumstances, the accountant ordinarily is in a position similar to that of, as applicable, a lead auditor that obtains the results of the work of an other auditor (*see generally* AS 1201, *Supervision of the Audit Engagement*, and AS 2101, *Audit Planning*), or an investor's auditor that obtains a report from an investee's auditor (*see generally* Appendix B of AS 1105, *Audit Evidence*).

XXXVII. AS 4105 is amended by revising footnote 28 to paragraph .39 to read as follows:

²⁸ If the auditor's report on the preceding year-end financial statements was other than unqualified, made reference to an audit and report of another public accounting firm, or

included an explanatory paragraph because of a going-concern matter or an inconsistency in the application of accounting principles, the second paragraph of the illustrative report in paragraph .39 should be appropriately modified.

XXXVIII. AS 4105 is amended by revising footnote 29 to paragraph .40 to read as follows:

²⁹ See AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*.

XXXIX. AS 4105 is amended by adding footnote 35 to paragraph .52 to read as follows

.52 Because of the different circumstances in individual engagements, it is not possible to specify the form or content of the documentation the accountant should prepare. However, the documentation should include any findings or issues that in the accountant's judgment are significant, for example, the results of review procedures that indicate that the interim financial information could be materially misstated, including actions taken to address such findings, and the basis for the final conclusions reached. In addition, the documentation should (a) enable members of the engagement team³⁵ with supervision and review responsibilities to understand the nature, timing, extent, and results of the review procedures performed; (b) identify the engagement team member(s) who performed and reviewed the work; and (c) identify the evidence the accountant obtained in support of the conclusion that the interim financial information being reviewed agreed or reconciled with the accounting records (see paragraph .18(d) of this section).

³⁵ The term "engagement team," as used in this standard for review engagements, has a meaning analogous to the term's definition in Appendix A of AS 2101 for audit engagements.

Amendments to AS 6115

XL. AS 6115 is amended by revising paragraph .24 to read as follows:

.24 The auditor should properly plan the engagement to report on whether a previously reported material weakness continues to exist and should properly supervise engagement team^{2A} members. When planning the engagement, the auditor should evaluate how the matters described in AS 2201.09 will affect the auditor's procedures.

^{2A} The term "engagement team," as used in this standard, has the same meaning as defined in Appendix A of AS 2101, *Audit Planning*.

XLII. AS 6115 is amended by revising the heading before paragraph .40 to read as follows:

Engagements Involving Other Accounting Firms

XLIII. AS 6115 is amended by revising paragraph .40 to read as follows:

.40 If an engagement to report on whether a previously reported material weakness continues to exist involves another accounting firm, the lead auditor⁴ must not divide responsibility for the engagement with the other accounting firm.

⁴ 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–.06C, which establish requirements regarding serving as the lead auditor. See also AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*.

Rescission of AI 10

XLIII. AI 10 is rescinded.

Amendment to AI 28

XLIV. AI 28 is amended by revising paragraph .12 to read as follows:

.12 *Interpretation*—Audit documentation is the written record of auditing procedures applied, evidence obtained, and conclusions reached by the auditor in the engagement. Audit documentation should include sufficient appropriate evidential matter to afford a reasonable basis for an opinion. In addition, audit documentation should be sufficient to enable members of the engagement team with supervision and review responsibilities to understand the nature, timing, extent, and results of auditing procedures performed, and the evidence obtained. See AS 1215, *Audit Documentation*.

Amendment to AT 1

XLV. AT 1 is amended by adding footnote 10A to the first note to paragraph 6 to read as follows:

Note: Due professional care imposes a responsibility on each engagement team^{10A} member to comply with this standard. The exercise of due professional care requires

critical review at every level of supervision of the work done and the judgment exercised by those assisting in the engagement, including preparing the report.¹¹

^{10A} The term “engagement team,” as used in this standard for examination engagements, has a meaning analogous to the term’s definition in Appendix A of AS 2101, *Audit Planning*, for audit engagements.

Amendment to AT 2

XLVI. AT 2 is amended by adding footnote 7A to the first note to paragraph 5 to read as follows:

Note: Due professional care imposes a responsibility on each engagement team^{7A} member to comply with this standard. The exercise of due professional care requires critical review at every level of supervision of the work done and the judgment exercised by those assisting in the engagement, including preparing the report.⁸

^{7A} The term “engagement team,” as used in this standard for review engagements, has a meaning analogous to the term’s definition in Appendix A of AS 2101, *Audit Planning*, for audit engagements.

Amendment to AT 101

XLVII. AT 101 is amended by adding footnote 22A to paragraph .103 to read as follows:

.103 Attest documentation should be sufficient to (a) enable members of the engagement team^{22A} with supervision and review responsibilities to understand the nature, timing, extent, and results of attest procedures performed, and the information obtained²³ and (b) indicate the engagement team member(s) who performed and reviewed the work. [Paragraph added, effective for attest engagements when the subject matter or assertion is as of or for a period ending on or after December 15, 2002, by Statement on Standards for Attestation Engagements No. 11.]

^{22A} The term “engagement team,” as used in this standard for attest engagements, has a meaning analogous to the term’s definition in Appendix A of AS 2101, *Audit Planning*, for audit engagements.

Amendment to Rule 1001

XLVIII. Section 1. General Provisions, Rule 1001 is amended by revising paragraph (p)(ii) to read as follows:

(p)(ii) Play a Substantial Role in the Preparation or Furnishing of an Audit Report

The phrase “play a substantial role in the preparation or furnishing of an audit report” means –

- (1) to perform material services that a public accounting firm uses or relies on in issuing all or part of its audit report, or
- (2) to perform the majority of the audit procedures with respect to a subsidiary or component of any issuer, broker, or dealer, the assets or revenues of which constitute 20% or more of the consolidated assets or revenues of such issuer, broker, or dealer necessary for the lead auditor to issue an audit report.

Note 1: For purposes of paragraph (1) of this definition, the term “material services” means services, for which the engagement hours or fees constitute 20% or more of the total engagement hours or fees, respectively, provided by the lead auditor in connection with the issuance of all or part of its audit report. The term does not include non-audit services provided to non-audit clients.

Note 2: For purposes of paragraph (2) of this definition, the phrase “subsidiary or component” is meant to include any subsidiary, division, branch, office or other component of an issuer, broker, or dealer, regardless of its form of organization and/or control relationship with the issuer, broker, or dealer.

Note 3: For purposes of determining “20% or more of the consolidated assets or revenues” under paragraph (2) of this Rule, this determination should be made at the beginning of the issuer’s, broker’s, or dealer’s fiscal year using prior year information and should be made only once during the issuer’s, broker’s, or dealer’s fiscal year.

Amendment to Rule 3211

XLIX. Rule 3211 is amended by revising Note 1 to paragraph (a) to read as follows:

Note 1: A Form AP filing is not required for an audit report of a registered public accounting firm that is referred to by the lead auditor in accordance with AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*.

Amendments to Form AP Instructions

L. The Form AP instructions are amended by revising Note 1 to General Instruction 3 to read as follows:

Note 1: A Form AP filing is not required for an *audit report* of a *registered public accounting firm* that is referred to by the Firm in accordance with AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*.

LI. The Form AP instructions are amended by revising the Note to Item 3.2 to read as follows:

Note: For purposes of Item 3.2, an *other accounting firm* participated in the Firm's audit if the *other accounting firm* or any of its principals or professional employees was subject to supervision under AS 1201, *Supervision of the Audit Engagement*.

LII. The Form AP instructions are amended by revising Item 3.3 to read as follows:

Item 3.3 Divided Responsibility

Indicate, by checking the box corresponding to this item, if the Firm divided responsibility for the *audit* in accordance with AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*, with one or more other *public accounting firm(s)*. If this item is checked, complete Part V.

LIII. The Form AP instructions are amended by revising Item 5.1 to read as follows:

Item 5.1 Identity of the Other *Public Accounting Firm(s)* When Responsibility Is Divided

(a) Provide the following information concerning each other *public accounting firm* the Firm divided responsibility with in the *audit*—

- (1) State the legal name of the other *public accounting firm* and when applicable, the other *public accounting firm's* Firm ID.
- (2) State the city and state (or, if outside the United States, city and country) of the office of the other *public accounting firm* that issued the other *audit report*.
- (3) State the magnitude of the portion of the financial statements audited by the other *public accounting firm*.

Note: In responding to Item 5.1.a.3, the Firm should state the dollar amounts or percentages of one of the following: total assets, total revenues, or other appropriate criteria, as it is described in the *audit report* in accordance with AS 1206.

APPENDIX 4

Additional Discussion of the Amendments and New Standard

I. INTRODUCTION

The changes to PCAOB standards set forth in this release are intended to improve the quality of audits that involve one or more public accounting firms, and accountants at those firms, that are outside the accounting firm issuing the auditor's report. This appendix discusses in more detail amendments to auditing standards and a new auditing standard adopted by the Public Company Accounting Oversight Board ("PCAOB" or "Board") relating to the use of other auditors and dividing responsibility for the audit with another accounting firm (collectively, "amendments" or "final amendments"). We are adopting these amendments after taking into account public comments that were received on the requirements proposed in 2016 ("2016 Proposal")¹ and in response to supplemental requests for comment issued in 2017 ("2017 SRC") and 2021 ("2021 SRC")² as discussed in more detail below in connection with the amendments.

In brief, the amendments include:

- Amendments to AS 1015, *Due Professional Care in the Performance of Work*; AS 1105, *Audit Evidence*; AS 1201, *Supervision of the Audit Engagement*; AS 1215, *Audit Documentation*; AS 1220, *Engagement Quality Review*; and AS 2101, *Audit Planning* (see Appendix 1 of this release);
- A new auditing standard, AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*, for situations in which the accounting firm issuing the auditor's report divides responsibility for the audit with another accounting firm (see Appendix 2 of this release); and
- Other related amendments to PCAOB auditing standards (see Appendix 3 of this release).

In general, the amendments extend the risk-based supervision requirements of PCAOB auditing standards to all situations in which other auditors participate in an audit, unless the

¹ See *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 See *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) and *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 (Sept. 28, 2021).

lead auditor divides responsibility for the audit with another auditor.³ The amendments also strengthen the requirements and provide additional direction to the lead auditor about its responsibilities. For the relatively infrequent situations when the lead auditor divides responsibility for the audit with another auditor, the amendments strengthen the existing approach under PCAOB standards.

The amendments also rescind AS 1205, *Part of the Audit Performed by Other Independent Auditors*, and AI 10, *Part of the Audit Performed by Other Independent Auditors: Auditing Interpretations of AS 1205*.

The amendments to AS 1201 and AS 2101 appear in the main body of each standard and in Appendix A of AS 2101. As originally proposed, most of the amendments to these standards would have appeared in a new Appendix B of each standard. As proposed in the 2021 SRC, the provisions that would have appeared in Appendix B were instead relocated to the body of the two standards (AS 1201 and AS 2101) to enhance the readability and usability of the amendments and to better facilitate their implementation. One commenter on the 2021 SRC commended the PCAOB for relocating the amendments from Appendix B of each standard to the body of the standards, stating that it improves usability and clarity.

II. DEFINITIONS OF ENGAGEMENT TEAM, LEAD AUDITOR, OTHER AUDITOR, AND REFERRED-TO AUDITOR

See paragraphs .A3–.A6 of AS 2101 in Appendix 1

To operationalize the requirements included in this release, the amendments define the terms “engagement team,” “lead auditor,” “other auditor,” and “referred-to auditor,” as discussed below. A commenter on the 2021 SRC recommended alignment of the terminology used in the PCAOB’s standards with that of the International Auditing and Assurance Standards Board (“IAASB”) and the American Institute of Certified Public Accountants Auditing Standards Board (“ASB”). After considering the comment, we are adopting the definitions substantially as proposed, because they are designed for the requirements of this rulemaking, which differ from those in the analogous IAASB and ASB standards. These definitions are included in Appendix A of AS 2101 and referenced in other PCAOB standards, where applicable.

A. Definition of “Engagement Team”

See paragraph .A3 of AS 2101 in Appendix 1

Under existing PCAOB standards, the engagement partner is responsible for the engagement and its performance, including the proper supervision of the work of engagement team members and for compliance with PCAOB standards.⁴ The term “engagement team” is

³ For situations involving auditors of the financial statements of the company’s investees, see Section VII.A below.

⁴ See AS 1201.03.

commonly used in PCAOB auditing standards but has not been defined. The definition of “engagement team” that the Board is adopting in AS 2101 will apply to AS 1201 and AS 2101, as amended, and to the new standard, AS 1206. The term specifies, for example, the persons subject to the lead auditor’s supervision under AS 1201, which standard will now apply to the relationship between the lead auditor and all other auditors for whose work the lead auditor assumes responsibility, including those currently covered by rescinded AS 1205.

We are adopting a revised definition to conform to previous amendments to the Board’s standards and to address 2021 SRC comments received. 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 2018.⁵ As revised, the definition of “engagement team” includes:

(1) Partners, principals, and shareholders of, and accountants⁶ 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, in connection with the audit, (i) are employed by the lead auditor or an other auditor participating in the audit and (ii) assist that auditor in obtaining or evaluating audit evidence with respect to a relevant assertion of a significant account or disclosure.⁷

The definition excludes:

(1) The engagement quality reviewer and those assisting the reviewer (to which AS 1220 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; and

⁵ See *Amendments to Auditing Standards for Auditor’s Use of the Work of Specialists*, PCAOB Release No. 2018-006 (Dec. 20, 2018).

⁶ See paragraph (a)(ii) of 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 AS 2101.A3.)

⁷ In the final amendments, we added the phrase “in connection with the audit” and replaced “assist their firm” with “assist that auditor” for clarity.

(3) Engaged specialists.⁸

In general, the engagement team, as defined, encompasses the engagement partner and individual accountants who perform procedures to obtain and evaluate audit evidence, as well as specialists employed by one of the participating audit firms who perform audit procedures. The following table illustrates the distinction between engagement team members and parties who are not engagement team members under the definition the Board is adopting.

Examples of Engagement Team Members	Examples of Parties Who are NOT Engagement Team Members
<ul style="list-style-type: none"> • Engagement partner • Personnel from the engagement partner’s firm⁹ who perform audit procedures on the audit 	<ul style="list-style-type: none"> • Auditor-engaged specialists¹⁰ • Engagement quality reviewer and those assisting the reviewer¹¹ • Appendix K or filing reviewer¹² • Service auditors of a third-party service organization¹³

⁸ 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 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 AS 2101.A3.)

⁹ The term “engagement partner’s firm” is used in this rulemaking to describe the registered public accounting firm issuing the auditor’s report. (See first note to AS 2101.A4.)

¹⁰ See AS 1210.

¹¹ AS 1220 applies to those persons.

¹² Reviewers under Appendix K of SEC Practice Section (“SECPS”) Section 1000.45, *SECPS Member Firms with Foreign Associated Firms That Audit SEC Registrants*, 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.

¹³ AS 2601, *Consideration of an Entity’s Use of a Service Organization*, sets forth the auditor’s responsibilities with respect to using the work of service auditors who issue reports on the controls of a third-party service organization.

Examples of Engagement Team Members	Examples of Parties Who are NOT Engagement Team Members
<ul style="list-style-type: none"> Personnel of accounting firms and individual accountants outside the engagement partner’s firm who perform audit procedures on the audit (supervised under AS 1201)¹⁴ A firm professional in the national office or centralized group in the firm (including within the firm’s network) who performs audit procedures on the audit or assists in planning or supervising the audit 	<ul style="list-style-type: none"> A firm professional who performs a contemporaneous quality control function (e.g., internal inspection or quality control review) but does not perform audit procedures or help plan or supervise the audit work Individuals employed or engaged by the company being audited, such as a company’s internal auditors, a company’s specialists, and a company’s consultants¹⁵

A commenter on the 2021 SRC asked whether the Board considered the potential ramifications of the difference between the proposed definition of “engagement team” and the analogous term “audit engagement team” in the Securities and Exchange Commission (“SEC”) independence requirements. One commenter acknowledged that the Board addressed this question in the 2016 Proposal and recommended that we add an explanatory footnote to the rule text in the definition of “engagement team.”

The Board is purposely adopting a definition of “engagement team” that is narrower than the definition of “audit engagement team” in the SEC’s independence rules. See Rule 2–01(f)(7)(i) of Regulation S-X, 17 C.F.R. § 210.2–01(f)(7)(i). In addition to the individuals within the Board’s definition of “engagement team,” the definition in SEC Rule 2–01(f)(7)(i) also encompasses certain individuals who are not included in the Board’s definition, such as the engagement quality reviewer. We note that neither the definition of “engagement team” nor

¹⁴ This includes personnel of accounting firms described in rescinded AS 1205 as other auditors for whose work the “principal auditor” (which is the term used in AS 1205) assumes responsibility. By including these individuals in the engagement team, the amendments expand the lead auditor’s responsibility to apply the risk-based supervision approach to all accounting firms involved in the audit, except in situations in which the lead auditor divides responsibility for the audit with another accounting firm. (If the lead auditor divides responsibility for the audit with another accounting firm, that firm is considered a referred-to auditor under AS 1206.)

¹⁵ Because of their roles at the company, the work of individuals employed or engaged by the company is not subject to supervision under AS 1201; they are not considered members of the engagement team under the adopted definition. PCAOB standards include requirements regarding the auditor’s use of work performed by some of these individuals. See, e.g., AS 1105, Appendix A; AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*; AS 2605, *Consideration of the Internal Audit Function*.

any other amendments in this release affect the definitions within, or the applicability of, the independence requirements of the SEC.

Another commenter expressed concern that the definition of “engagement team” for purposes of AS 2101, AS 1201, and AS 1206 could have implications for other standards. This commenter cited other auditing standards outside of these three standards that use the term “engagement team” and encouraged the PCAOB to revisit these instances to determine the implications for those standards of the new definition. We note that, although the definition is not repeated across all other PCAOB standards, the term “engagement team” in other PCAOB standards has the same meaning as the defined term in AS 2101.A3.¹⁶

Finally, a couple of commenters recommended clarifying the definition of “engagement team” with respect to auditor-employed specialists. One commenter suggested specifying that auditor-employed specialists can be engagement team members only if they participate in the audit, while the other suggested changing the proposed reference to “their firm” to instead employ the defined terms “lead auditor” and “other auditor.” We have made corresponding clarifying edits to subparagraph (2) of the definition. Apart from making these changes and certain minor clarifying edits, the Board is adopting the definition of “engagement team” as proposed in the 2021 SRC.

B. Definition of “Lead Auditor”

See paragraph .A4 of AS 2101 in Appendix 1

The amendments introduce the new term “lead auditor” for both types of scenarios addressed by this rulemaking: supervising other auditors’ work under AS 1201, and dividing responsibility for the audit with another accounting firm under AS 1206.¹⁷ The term “lead auditor” replaces the term “principal auditor” that is currently used in several PCAOB standards.¹⁸ Under the amendments, the term “lead auditor” means the firm issuing the auditor’s report, the engagement partner of that firm, and other personnel of that firm (or their functional equivalents) who perform planning or supervisory responsibilities from that firm.

The definition is key to this rulemaking because it identifies the firm and individuals who are responsible for carrying out the requirements under the amendments:

¹⁶ See Appendices 1 and 3 in this release for further amendments made to PCAOB standards in order to clarify that the term “engagement team” has the same meaning (or, where applicable, analogous meaning) as the defined term in AS 2101.A3.

¹⁷ The amendments rescind AS 1205, which uses the term “principal auditor.”

¹⁸ See Appendix 3 in this release.

Lead auditor –

- (a) The registered public accounting firm¹⁹ 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 1201.²⁰

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 secondees²¹ 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.

Several commenters on the 2021 SRC indicated that the definition of “lead auditor” was sufficiently clear. One commenter on the 2021 SRC stated there was lack of clarity about the use of the term “lead auditor” in circumstances when the audit does not involve other auditors or referred-to auditors. This commenter suggested that the proposed standard explicitly

¹⁹ See paragraph (r)(i) of PCAOB Rule 1001, which defines the term “registered public accounting firm.” This footnote is included within the definition appearing in AS 2101.A4.

²⁰ 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 AS 1015.06, 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 is included within the definition appearing in AS 2101.A4.

²¹ For this purpose, the term “secondee” refers to an individual participating in a secondment arrangement in which, for at least three consecutive months, (1) a professional employee of an accounting firm in one country works for a registered public accounting firm that is located in another country and is issuing an auditor’s report, and (2) the professional employee performs audit procedures with respect to entities and their operations in that other country and does not perform more than de minimis audit procedures in relation to entities or business operations in the country of his or her employer. A secondee can be either physically located in that other country or working through a remote work arrangement. This footnote is included within the definition appearing in AS 2101.A4.

acknowledge either: (1) the registered public accounting firm that issues the auditor's report is always the lead auditor, including when there are no other auditors or referred-to auditors or (2) the registered public accounting firm that issues the auditor's report is only a lead auditor if the audit involves other auditors or referred-to auditors (and therefore modifications would need to be made to the definition of engagement team).

In the proposing releases, we stated that the term "lead auditor" would apply to these scenarios: supervising other auditors under AS 1201 and dividing responsibility for the audit under proposed AS 1206. In addition, the amendments already clearly indicate that the term will apply when other auditors or referred-to auditors are involved in the audit.²²

The description of "seconded" was added to the proposed amendments in the 2021 SRC.²³ Several commenters said that the description was too prescriptive, given the flexibility in location where audit professionals may work, as demonstrated throughout the COVID-19 pandemic. Most of these commenters were supportive of its inclusion as an example in the rule text, but recommended that "seconded" not be defined so narrowly. They also suggested that individuals who work at shared service centers be included as an example in the rule text given the continued increase in their use. In addition, one commenter said that it did not agree with the Board that at all times (now and in the future) individuals who work at shared service centers will work under the direction and control of and function as employees of the lead auditor firm.

After considering the comments received, the Board is revising footnote 5 of AS 2101.A4 to be similar to revised Form AP staff guidance²⁴ on secondees. Those revisions recognized that, because of the recent advances in technology and remote work arrangements, location should not necessarily be a factor in determining whether secondees work under the direction and control of the firm and function as their employees. Further, the Board agrees that under the amendments secondees from other accounting firms and employees of shared service centers who both work under the firm's direction and control (as with other individuals who work in the role of firm employees) *and* assist the engagement partner in fulfilling planning or supervisory responsibilities on the audit are part of the lead auditor.

Regarding the comment that individuals at shared service centers would not always function as "employees of the lead auditor's firm," the amendments do not provide that all shared service center staff would function as employees of the lead auditor firm. For example, staff at a shared service center could be working on the audit under the direction and control of

²² See, e.g., AS 2101.04.

²³ See 2021 SRC at A1-16 (proposed footnote 5 of AS 2101.A4).

²⁴ See Staff Guidance, *Form AP, Auditor Reporting of Certain Audit Participants, and Related Voluntary Audit Report Disclosure Under AS 3101, The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion* (Dec. 17, 2021).

an audit firm other than the lead auditor. In that case, the individuals at the shared service center would function as employees of the other auditor, not the lead auditor firm.

The Board considered these comments and determined that the proposed definition of lead auditor is sufficiently clear and, except for the revision to the footnote regarding secondees discussed above, is adopting it as proposed in the 2021 SRC.

C. 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.

Several existing PCAOB standards use the term “other auditor” to encompass any auditors outside the lead auditor that participate in an audit, regardless of whether the lead auditor supervises them under AS 1201, assumes responsibility for their work under AS 1205, or makes reference to them under AS 1205.²⁵ The amendments define two terms: “other auditor,” and “referred-to auditor”. These definitions are as follows:

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 units²⁶ and issues an auditor’s report in accordance with the standards of the PCAOB to which the lead auditor makes reference in the lead

²⁵ For example, AS 1205 uses the term “other auditors” to describe accounting firms whose work the lead auditor uses or with which it divides responsibility for the audit. By contrast, AS 1215.18–.19 uses the term “other auditors” when describing offices of the firm issuing the audit report and other firms participating in the audit.

²⁶ The term “business units” includes subsidiaries, divisions, branches, components, or investments. This footnote is included within the definition appearing in AS 2101.A6.

auditor's report on the company's financial statements and, if applicable, internal control over financial reporting.²⁷

Several commenters on the 2021 SRC indicated that the definition of "other auditor" was sufficiently clear, and no commenters expressed concern about the definition of "referred-to auditor." Some commenters on the 2016 Proposal asked whether the term "referred-to auditor" is aligned with the term "principal accountant" used by the SEC. We note that the definitions we are adopting do not affect the applicability of SEC terms or rules to audits involving other auditors or referred-to auditors, including the definition of "principal accountant."

In addition, one commenter on the 2016 Proposal stated that the only difference between the definitions of other auditor and referred-to auditor appears to be divided responsibility, but noted the definitions are substantially different. The Board notes that these definitions reflect differences in lead auditor responsibilities with respect to the other auditor and referred-to auditor. As noted above, under the amendments, the term "other auditor" encompasses both the individuals participating in the audit and their firm. In contrast, the lead auditor divides responsibility for the audit with the referred-to auditor, which issues the auditor's report on the financial statements (and, if applicable, internal control over financial reporting) of a company's business unit. Thus, the term "referred-to auditor" applies only to the firm because the firm issues an auditor's report in the divided-responsibility situation.

The Board considered the comments and determined that the definitions of "other auditor" and "referred-to auditor" are sufficiently clear and is adopting them as proposed in the 2021 SRC.

III. PLANNING THE AUDIT

See amendments to AS 2101 in Appendix 1

In general, the amendments to AS 2101 carry forward and update certain requirements of AS 1205 and include certain procedures to be performed by the lead auditor.

This section of the appendix discusses planning requirements in AS 2101 for audits in which the lead auditor supervises the work of other auditors in accordance with AS 1201. It also discusses certain planning requirements, which appear in AS 2101, for audits in which the lead

²⁷ 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. This footnote is included within the definition appearing in AS 2101.A6.

auditor divides responsibility for the audit with referred-to auditors in accordance with AS 1206.²⁸ This section on planning requirements addresses the following topics:

- Serving as the lead auditor in an audit that involves other auditors or referred-to auditors (determining sufficiency of participation);
- Other auditors' compliance with independence and ethics requirements;
- PCAOB registration status of other auditors;
- Knowledge, skill, and ability of and communications with other auditors; and
- Determining locations or business units at which audit procedures should be performed.

A. Serving as the Lead Auditor in an Audit that Involves Other Auditors or Referred-to Auditors (Determining Sufficiency of Participation)

See paragraphs .06A–.06C of AS 2101 in Appendix 1

Under AS 2101 as amended, in audits involving 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. The considerations for determining the sufficiency of the firm's participation apply to audits in which the lead auditor supervises other auditors' work, divides responsibility for the audit with another accounting firm, or both. In contrast, the 50-percent participation threshold (discussed in item 2 below) applies only to audits in which the lead auditor divides responsibility for the audit with another accounting firm.

Planning is not a discrete phase of an audit, but rather is a continual and iterative process that continues until the completion of the audit.²⁹ Therefore the engagement partner is expected to revisit his or her determination of the sufficiency of the lead auditor's participation throughout the audit if circumstances change. This may occur, for example, because of changes due to business combinations, divestitures, or other events that could affect the audit plan or allocation of work between the lead auditor and other auditors.

²⁸ In addition, Section VI of this appendix discusses requirements for the lead auditor in AS 1206 relating to the referred-to auditor's (1) compliance with the SEC independence and PCAOB independence and ethics requirements, (2) registration pursuant to the rules of the PCAOB, and (3) knowledge of the relevant accounting, auditing, and financial reporting requirements.

²⁹ See AS 2101.05.

1. Considerations for Serving as the Lead Auditor

See first paragraph of .06A(a-c) of AS 2101 in Appendix 1

AS 1205, which is being rescinded, provides that when significant parts of the audit are performed by other auditors (“other auditors” and “referred-to auditors” under the amendments), the principal auditor (“lead auditor” under the amendments) must decide whether the principal auditor’s own participation is sufficient to enable it to serve as the principal auditor and issue the auditor’s report on the company’s financial statements. Under AS 1205.02, when determining whether the firm sufficiently participates in the audit, the principal auditor is required to consider, among other things, (i) the materiality of the portion of the financial statements audited in comparison with the portion audited by other auditors; (ii) the extent of the auditor’s knowledge of the overall financial statements; and (iii) the importance of the components audited by the auditor in relation to the enterprise as a whole.

The amendments to AS 2101 strengthen the existing requirement for determining the sufficiency of participation by: (i) extending the determination requirement to *all* audits involving other auditors and referred-to auditors,³⁰ not just audits that have been covered by AS 1205; (ii) imposing the determination requirement specifically on the engagement partner; and (iii) specifying certain considerations, based on risk and other factors, that should be taken into account in making the determination.

In general, the sufficiency requirement is intended to increase the likelihood that the firm issuing the auditor’s report (i.e., the lead auditor) meaningfully participates in the audit. The Board believes that compliance with this requirement should benefit all audits involving other auditors and referred-to auditors, not only audits that have been covered by AS 1205. Imposing the sufficiency requirement on the engagement partner is consistent with the engagement partner’s existing responsibilities under PCAOB standards for planning the audit³¹ and for assigning tasks to and supervising engagement team members.³²

The amendments require that, when making the sufficiency determination, the engagement partner take into account the following, in combination, i.e., the engagement partner should take into account all three considerations:

- *Importance* – The importance of the locations or business units for which the engagement partner’s firm performs audit procedures in relation to the financial

³⁰ Section VI of this appendix discusses further conditions to be met in order to divide responsibility with another accounting firm.

³¹ See AS 2101.03.

³² See AS 1015.06.

statements of the company as a whole, considering quantitative and qualitative factors;

- *Risk* – 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
- *Extent of supervision* – The extent of the engagement partner’s firm’s supervision of the other auditors’ work for portions of the company’s financial statements for which the other auditors perform audit procedures.³³

Of these three considerations, only the risk consideration was included in the 2016 Proposal. Although it was intended to encompass both quantitative and qualitative aspects of participation, some commenters on the 2016 Proposal viewed a determination based solely on risk as too narrow, and some viewed it as primarily quantitative. Commenters expressed concern that it might result in denying a firm the ability to serve as lead auditor if it performed procedures only at the corporate headquarters and not at the company’s operating units (which were audited by other auditors), even if that firm is otherwise best positioned to serve as lead auditor.

The importance consideration was added in the 2017 SRC, after considering comments received on the 2016 Proposal. The addition was intended to more expressly address circumstances in which the lead auditor audits the locations or business units where the primary financial reporting decisions are made and consolidated financial statements are prepared, even though those locations or business units might not constitute a significant portion of the company’s operations.³⁴ A number of commenters on the 2017 SRC commented favorably on 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 on the 2017 SRC viewed the sufficiency determination based on the two proposed considerations (importance and risk) as too restrictive for certain audits. Examples provided by the commenters included companies with highly dispersed management and financial reporting functions, especially those whose operations, headquarters, and financial reporting functions are primarily outside the company’s corporate domicile. Commenters stated that applicable laws and regulations might require that the company’s audit report be issued by a firm located in the jurisdiction where the company is domiciled,

³³ In a multi-tiered audit (see AS 1201.14), the consideration regarding extent of supervision applies only to the firm’s supervision of a first other auditor and any other auditor that is supervised directly by the firm. See discussion of multi-tiered audits in Section V below.

³⁴ See 2017 SRC at 9.

regardless of how much of the audit is performed by that auditor compared to other auditors. To address this issue, the commenters suggested providing additional considerations for the sufficiency-of-participation determination, including the firm's extent of supervision.

The third consideration (extent of supervision) was added in the 2021 SRC. This addition was designed to allow for a more comprehensive determination of the prospective lead auditor's involvement.

Several commenters on the 2021 SRC generally supported the proposed addition of the consideration related to the extent of the engagement partner's firm's supervision of other auditors' work. Some of these comments also agreed that the sufficiency-of-participation determination by the engagement partner should be a risk-based assessment involving quantitative and qualitative considerations. One commenter on the 2021 SRC stated its understanding that an engagement partner may determine that his or her firm can serve as lead auditor by adjusting the extent of his or her firm's supervision of the other auditors' work to overcome instances where the other auditors are performing audit procedures for significant parts of the audit. This same commenter said it would be helpful for the Board to acknowledge that an auditor who performs relatively fewer audit procedures on global business units can still be considered the lead auditor based on legal or regulatory requirements and his or her firm's supervision of other auditors.

Other commenters continued to have concerns similar to those expressed in 2017 (e.g., regarding jurisdictional matters) even with the additional consideration. These commenters suggested that the Board provide further considerations, and therefore additional flexibility, for the determination.

We believe the three considerations will enable engagement partners to address the multitude of scenarios encountered in practice when determining their firms' sufficiency of participation. With regard to the comments on jurisdictional challenges posed by laws and regulations, if the auditor's report is required to be issued by a firm licensed in a certain jurisdiction, under the amendments that firm could serve as lead auditor (subject to certain conditions such as necessary extent of supervision), even if it does not perform audit procedures on many of the company's subsidiaries. In addition, a firm could obtain additional staff to perform audit procedures under the firm's direction and control functioning as the firm's employees in order to be able to serve as the lead auditor. Adding more considerations, as some commenters suggested, could increase the risk that the firm issuing the auditor's report does not meaningfully participate in the audit, and thus was the "lead auditor" in name only.³⁵ Permitting such arrangements would not achieve the intent of the amendments.

One commenter pointed out that with respect to divided-responsibility situations, the lead auditor often may not be able to fully apply certain considerations (e.g., the concept of

³⁵ Such arrangements are sometimes referred to as "letterbox audits."

“supervision” in AS 2101.06Ac). We note that in a divided-responsibility situation, the overall principles of .06Aa-b are the relevant considerations, because the consideration in .06Ac does not by its terms address referred-to auditors. AS 2101.06Ac states that the “extent of the engagement partner’s firm’s supervision of the *other auditors’* work for portions of the company’s financial statements for which the *other auditors* perform audit procedures” (emphasis added).

After considering the comments received, we are adopting the requirements substantially as proposed.³⁶ The engagement partner will take into account the three considerations (importance, risk, and supervision) in combination to determine whether the full range of his or her firm’s involvement in the audit constitutes sufficient participation to serve as the lead auditor.³⁷

2. Fifty-Percent Participation Threshold for Divided-Responsibility Audits

See second paragraph of .06A of AS 2101 in Appendix 1.

For divided-responsibility audits,³⁸ the Board has determined to adopt, as proposed, amendments to reflect the following “50-percent threshold,” which applies *in addition* to two of the three considerations for determining the sufficiency of participation discussed above (importance and risk):³⁹

[T]he 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.

This 50-percent threshold is intended to reduce the likelihood that the lead auditor divides responsibility with an accounting firm or firms that audit a majority of the company’s

³⁶ Footnote 4B to AS 2101.06Ac has been revised to add the following sentence: “*See also AS 1201.07, which states that for engagements that involve other auditors, AS 1201.08–.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 AS 1201.*”

³⁷ The lead auditor’s analysis of its sufficiency of participation should be documented pursuant to AS 1215.06, which requires, among other things, that audit documentation contain sufficient information to enable an experienced auditor, having no previous connection with the engagement, to understand the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached.

³⁸ 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 in 2021, 2020, 2019, and 2018 disclosed 36, 41, 37, and 42 divided-responsibility audits, respectively.

³⁹ Section VI.B.4 of this appendix discusses further conditions to be met in order to divide responsibility with another accounting firm.

assets or revenue, and is consistent with the Board's approach to reinforcing the accountability of the lead auditor in audits involving other auditors.⁴⁰ Including this threshold in the amendments also preserves a longstanding practice of the profession.

One commenter on the 2021 SRC asserted (with respect to the 50-percent threshold for divided-responsibility audits) that a firm's analysis as to whether it can reasonably serve as lead auditor must consider all the facts and circumstances, rather than simply consolidated assets or revenues. Another commenter asked that the wording of the 50-percent threshold be revised when referred-to auditors are involved because there are scenarios in which either assets or revenues audited by the referred-to auditor are greater than the assets or revenues audited by the lead auditor, such as when consolidated revenues of the company overall are nominal, but the amounts that do exist are audited by the referred-to auditor. This commenter believed that use of the term "or" will allow for false positives and restrict the ability of lead auditors to make reference to referred-to-auditors.

After considering the comments, the Board is adopting the 50-percent threshold as proposed. That threshold creates a presumption (not a bright line test) that the lead auditor will not divide responsibility with an accounting firm or firms that audit a majority of the company's assets or revenues.⁴¹ A firm could overcome the presumption and serve as lead auditor in exceptional situations, involving, for example, late-year acquisitions or other unanticipated events or conditions that increase the portion of assets or revenues audited by referred-to auditors beyond the 50-percent threshold. Under PCAOB standards, the firm would need to document why its participation in the audit was sufficient to serve as lead auditor, including how the firm satisfied the criteria based on the importance of the locations or business units it audited and risks of material misstatement associated with the portion of the company's financial statements that it audited.

The description of the 50-percent threshold in the amendments differs from the analogous description in the Corp. Fin. Manual because the PCAOB description uses terminology consistent with the amendments (whereas the Corp. Fin. Manual's formulation uses terminology consistent with pre-amendment standards) and because the PCAOB description is written in the negative: "in an audit that involves referred-to auditors ... the participation of the engagement partner's firm ordinarily is *not sufficient for it to serve as lead*

⁴⁰ The threshold is similar to a quantitative threshold that appears in staff guidance set forth in the Financial Reporting Manual of the SEC Division of Corporation Finance ("Corp. Fin. Manual"). The Corp. Fin. Manual provides that a lead auditor is generally expected to have audited or assumed responsibility for at least 50 percent of the assets and revenues of the consolidated entity. See SEC, Division of Corporation Finance, Financial Reporting Manual, Section 4140.1.

⁴¹ Notably, while the comparison based on the importance of the locations or business units and risks of material misstatement associated with the portion of the financial statements is made singly (i.e., with regard to the engagement partner's firm's participation), the additional threshold based on assets and revenue is made with regard to all referred-to auditors in the aggregate.

auditor if the referred-to auditors, in aggregate, audit more than 50 percent of the company's assets or revenues."

3. Supervising Based on Risk

See paragraph .06B of AS 2101 in Appendix 1.

In some audits, the lead auditor might decide to increase the extent of its supervision of other auditors' work to provide additional support for the sufficiency-of-participation determination. Although this practice would contribute to the lead auditor's participation to some extent, performing additional supervisory procedures with respect to the other auditors does not, by itself, relieve the lead auditor of its own obligation to perform meaningful audit procedures in the audit.

The amendments do not allow an audit firm to serve as lead auditor when all of the audit procedures are performed by other auditors, even under the lead auditor's supervision. A determination to serve as lead auditor under the amendments needs to be supported by a combination of supervision of other auditors by the lead auditor and the lead auditor's performance of audit procedures.

In particular, the Board believes that a lead auditor, as the firm that issues the audit report, should perform audit procedures to a meaningful extent even if the company's business operations and financial reporting functions are located in a different country than the lead auditor. The following are examples⁴² of such procedures:

- *Procedures related to risks pervasive to the financial statements, such as risk assessment procedures directed to risks to the consolidated financial statements as a whole.*⁴³
- *Procedures related to the consolidated financial statements, such as audit procedures regarding the period-end financial reporting process⁴⁴ for the consolidated financial statements, and evaluation of the presentation of the consolidated financial statements, including the disclosures.*⁴⁵

⁴² In addition, the lead auditor would perform audit procedures with respect to locations or business units selected for testing that the lead auditor assigned to itself.

⁴³ See AS 2110.59b.

⁴⁴ See AS 2301.41.

⁴⁵ See paragraphs .30–.31 of AS 2810, *Evaluating Audit Results*.

- *Other procedures related to the overall evaluation of audit results, such as performing overall analytical review procedures;⁴⁶ evaluating accumulated misstatements;⁴⁷ evaluating identified control deficiencies;⁴⁸ evaluating the qualitative aspects of the overall financial statements, including potential management bias;⁴⁹ evaluating conditions related to fraud risk assessment;⁵⁰ and evaluating the sufficiency and appropriateness of the audit evidence obtained.⁵¹*

In these examples, the lead auditor would not need to perform these procedures exclusively. Rather, it could ask other auditors for assistance with some aspects of the above procedures, such as obtaining audit evidence relating to the business units assigned to the other auditors.

In the amendments, AS 2101.06B, which is intended to be a reminder concerning existing requirements, provides 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 requirement draws from existing requirements in AS 1201, AS 2101, and AS 2301, which require greater involvement in areas of greater risk.⁵² No commenters opposed the requirement.

The Board is adopting this provision as proposed.

4. Sufficiency Considerations in an Integrated Audit of Financial Statements and Internal Control Over Financial Reporting

See paragraph .06C of AS 2101 in Appendix 1.

In the amendments, AS 2101.06C states that in an integrated audit of a company's financial statements and its internal control over financial reporting ("ICFR") that involves other

⁴⁶ See AS 2810.07–.09.

⁴⁷ See AS 2810.10–.23.

⁴⁸ See AS 2201.62–.70.

⁴⁹ See AS 2810.24–.27.

⁵⁰ See AS 2810.28–.29.

⁵¹ See AS 2810.32–.36.

⁵² See footnote 4C of AS 2101.06B, which cites, as examples, AS 1201.06, 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."), and, more generally, AS 2301.

auditors or referred-to auditors, the lead auditor of the financial statements must participate sufficiently in the audit of ICFR to provide a basis for serving as the lead auditor of ICFR. Only the lead auditor of the financial statements can be the lead auditor of ICFR. This amendment incorporates an existing requirement from AS 2201 regarding the sufficiency of the lead auditor's participation in the integrated audit of financial statements and ICFR.⁵³ No commenters objected to this requirement, and the Board is adopting it as proposed.

B. Other Auditors' Compliance with Independence and Ethics Requirements

*See paragraphs .06D and .06F of AS 2101 in Appendix 1*⁵⁴

The amendments to AS 2101 relating to auditor independence and ethics requirements build on the existing, overarching responsibility of the auditor to determine compliance with independence and ethics requirements.⁵⁵ The amendments are designed to position the lead auditor to identify matters that warrant further attention when determining the other auditor's compliance with those requirements. Commenters on the proposing releases generally agreed that the lead auditor should perform procedures regarding other auditors' compliance with these requirements. Several commenters, however, raised questions about specific aspects of the provisions, which are discussed below in items 1 through 5.

1. Understanding the Other Auditor's Knowledge and Experience; Obtaining an Affirmation about Policies and Procedures, Changes in Circumstances

See paragraphs .06Da, .06Db(1), and .06Dc(1) – (2) of AS 2101 in Appendix 1

The Board is adopting the amendments discussed in this section as they were proposed in the 2021 SRC. The amendments in AS 2101.06D require the lead auditor to perform certain procedures "in conjunction with determining compliance with" independence and ethics requirements, to carry out its responsibilities pursuant to the existing requirements in paragraph .06b of AS 2101.

⁵³ See conforming amendments to AS 2201.C8, .C10, and .C11 in Appendix 3. The terminology in these paragraphs has been updated to align with the amendments, without changing the intent of the requirements in these paragraphs.

⁵⁴ See Section V 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 AS 1206 (in Appendix 2) for requirements relating to audits involving referred-to auditors.

⁵⁵ See AS 2101.06b (requiring the auditor to "[d]etermine compliance with independence and ethics requirements" at the beginning of the audit and to reevaluate the determination throughout the audit). As noted above, the use of "independence and ethics requirements" in this release refers to PCAOB independence and ethics requirements and SEC independence requirements.

AS 2101.06Da requires that the lead auditor obtain an understanding of the other auditor's knowledge of independence and ethics requirements and its experience in applying the requirements. AS 2101.06Db(1) requires that the lead auditor obtain from the other auditor and review a written affirmation⁵⁶ 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 is 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.

The amendments require 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.⁵⁷ These amendments are meant to provide the lead auditor with information necessary for it to reevaluate compliance with independence and ethics requirements.⁵⁸ Communications required by the amendments also reflect policies already adopted by a number of registered firms.

The Board notes that the nature and extent of the lead auditor's procedures for obtaining an understanding under paragraph .06Da will depend on the types of information available to the lead auditor about the other auditor. The following are examples of types of information that may be relevant to the lead auditor's understanding of the other auditor's knowledge of independence and ethics requirements, and the other auditor's experience in applying the requirements:

- The type, frequency, and substance of independence and ethics training that the other auditor provides to its personnel who participate in the audit;
- The other auditor's policies and procedures for ensuring that the firm and its personnel comply with independence and ethics requirements, including PCAOB Rule 3520, *Auditor Independence*,⁵⁹

⁵⁶ The final 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., AS 1206*).

⁵⁷ *See AS 2101.06Dc, which applies to all affirmations and descriptions required by paragraph .06Db.*

⁵⁸ *See note to AS 2101.06b regarding reevaluating compliance.*

⁵⁹ *See also QC 20, System of Quality Control for a CPA Firm's Accounting and Auditing Practice.*

- The other auditor’s process for determining that the other auditor, including the firm and its applicable personnel, does not have financial or employment relationships that might impair the lead auditor’s independence on the audit;⁶⁰
- The other auditor’s process for obtaining timely information about the audit client and its affiliates from which the other auditor firm is required to maintain independence, including an understanding of all non-audit services initiated or about to be initiated for the audit client by the other auditor;⁶¹ and
- Any business relationships between the other auditor (including the firm and its applicable personnel) and the audit client, or persons associated with the audit client in a decision-making capacity, such as officers, directors, or substantial stockholders.⁶²

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 their 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.

Commenters on the 2021 SRC generally supported the modifications made to proposed AS 2101.06D, including the requirement to obtain written affirmations from the other auditor about whether the other auditor’s policies and procedures provide reasonable assurance of compliance with independence and ethics, and whether the other auditor is in compliance. However, some commenters asked the Board to modify the requirements for the written affirmation and noted that a firm’s quality control assessment with respect to independence is done on an annual basis. These commenters recommended that the Board align the amendments in this rulemaking with those of the PCAOB’s project regarding quality control standards.⁶³ In the view of one of these commenters, it was not the Board’s intention to require

⁶⁰ See Rules 2-01(c)(1) and 2-01(c)(2) of Regulation S-X, 17 C.F.R. §210.2-01(c)(1) and 17 C.F.R. §210.2-01(c)(2).

⁶¹ PCAOB and SEC independence rules define “affiliate of the audit client.” See PCAOB Rule 3501(a)(ii); Rule 2-01(f)(4) of Regulation S-X, 17 C.F.R. § 210.2-01(f)(4). For rules regarding the prohibition of non-audit services, see Rules 2-01(c)(4) and 2-01(b) of Regulation S-X, 17 C.F.R. § 210.2-01(c)(4) and 17 C.F.R. § 210.2-01(b); PCAOB Rule 3522, *Tax Transactions*; and PCAOB Rule 3523, *Tax Services for Persons in Financial Reporting Oversight Roles*. See also PCAOB Rule 3521, *Contingent Fees*.

⁶² See Rule 2-01(c)(3) of Regulation S-X, 17 C.F.R. § 210.2-01(c)(3).

⁶³ *Concept Release: Potential Approach to Revisions to PCAOB Quality Control Standards*, PCAOB Release No. 2019-003 (Dec. 17, 2019).

the other auditor engagement team members to make their own conclusion about an aspect of their firm's quality control system relative to a particular engagement.

Even in circumstances when other auditor engagement team members rely on their firm's quality control system for independence and ethics compliance, we believe it is appropriate to require the lead auditor to request and obtain in the context of an audit an affirmation that the other auditor's firm has the necessary policies and procedures. In practice, audit engagement teams typically exchange information with their own firm's quality control function relating to compliance with certain independence and ethics requirements. However, if an other auditor does not have policies and procedures that provide reasonable assurance that it complies with such requirements, it is appropriate to require that the lead auditor request and obtain a description of how the other auditor determines its compliance with the independence and ethics requirements. We believe that this requirement is appropriate today and will remain appropriate after firms implement the IAASB's newly adopted International Standard on Quality Management 1 ("ISQM 1"), which will require firms that perform audits under IAASB standards to evaluate the effectiveness of its quality control system, or under PCAOB standards if the Board were to adopt a similar requirement.⁶⁴

In addition, a couple of commenters suggested requiring that the lead auditor make the other auditor aware of PCAOB and SEC independence requirements that are relevant to the company.

The requirement for the lead auditor to obtain an understanding (pursuant to paragraph .06Da) is designed to assist the lead auditor in determining its course of action regarding the other auditor's independence and ethics compliance. For example, other auditors with less knowledge and experience may be less able to provide the information the lead auditor needs to determine compliance with independence and ethics requirements. The lead auditor may need to communicate PCAOB and SEC independence requirements to some other auditors (e.g., those who are less familiar with the requirements) but not to others (e.g., those who are more familiar with the requirements). The Board believes the amendments are sufficiently principles-based to allow the lead auditor to adjust its procedures according to the circumstances of the audit, including with respect to:

- Making other auditors aware of the relevant independence and ethics requirements for the audit engagement, including affirming compliance not only with respect to their audit client, but also with respect to any affiliates of that audit client;
- Confirming that the other auditors understand the requirements; and

⁶⁴ The IAASB adopted ISQM 1 in December 2020, and it will become effective on December 15, 2022. See IAASB, *ISQM 1, Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements* (Dec. 17, 2020).

- Considering whether additional information for other auditors is necessary regarding the independence and ethics requirements that are relevant to the audit engagement.

With respect to AS 2101.06Dc(1) – (2), one commenter stated that it is not necessary for other auditors to reaffirm in writing every update that is communicated by the lead auditor. We believe that an informative record of relevant matters is important for determining compliance with independence and ethics requirements. Auditor independence is critical for an effective audit; lack of independence can compromise the effectiveness of audit procedures performed by the other auditor. The amendments are designed to provide the lead auditor with timely information indicating that the other auditor’s independence may be compromised, thus enabling the lead auditor to take any necessary action during the course of the audit.

2. Obtaining a Written Description of the Other Auditor’s Covered Relationships

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

Under the 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 client⁶⁵ 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*.⁶⁶ The requirement is designed to assist the lead auditor in obtaining information for determining compliance with SEC and PCAOB independence requirements and to facilitate auditor communications to the audit committee under Rule 3526. The amendments do not change the applicability of Rule 3526 to the lead auditor’s representation, *including* with respect to unaffiliated firms.⁶⁷

⁶⁵ 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.” The terms used in AS 2101.06Db(2) have the same meaning as defined in Rule 3501.

⁶⁶ Rule 3526 requires auditors 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.

⁶⁷ *See Ethics and Independence Rule 3526, Communication with Audit Committees Concerning Independence*, PCAOB Release No. 2008-003 (Apr. 22, 2008), at 5 note 4, which states that the Board

One commenter supported the proposed requirement, noting that PCAOB Rule 3526 requires communication only from the lead auditor to the audit committee. The commenter added that the proposed new requirement – with respect to the lead auditor determining an other auditor’s compliance with independence and ethics requirements rather than simply inquiring about it (e.g., under extant AS 1205) – aligns the responsibility to make such determination better with the required communication.

No commenters opposed this requirement, and the Board is adopting it as proposed.

3. Obtaining a Written Affirmation about the Other Auditor’s Compliance with Independence and Ethics Requirements

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

Under the 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, the lead auditor should obtain and review a written description of the nature of the instances of non-compliance. This requirement was originally introduced in the 2016 Proposal, to strengthen a requirement in AS 1205, which is being rescinded, to make inquiries concerning the other auditor’s independence.⁶⁸ This provision was revised and clarified in the amendments proposed in the 2017 and 2021 SRCs to require in addition that the lead auditor obtain and review a description of the nature of the instances of any non-compliance.

One commenter on the 2021 SRC recommended that the Board modify the proposed requirement to also include the other auditor’s conclusion regarding whether it is capable of exercising objective and impartial judgment on all issues encompassed in its work. In response, the Board notes that the lead auditor can determine its course of action based on the facts and circumstances of the audit engagement, without the Board prescribing a course of action in the amendments. Therefore, the Board is not making additional changes to this requirement and is adopting it as proposed.

4. Following Up on Contrary Information

See paragraph .06F of AS 2101 in Appendix 1

The amendments to AS 2101 direct the lead auditor to follow up on contrary information. The amendments provide that if the lead auditor becomes aware of information that contradicts the other auditor’s affirmation or description (including information about changed circumstances), the lead auditor should investigate the circumstances and consider

“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” (emphasis added).

⁶⁸ See AS 1205.10b.

the reliability of the affirmation or description. Further, if, after such investigation, or based on the other auditor's affirmation or description, there are indications that the other auditor is 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.

Two commenters on the 2021 SRC expressed concerns with the words "investigate" and "investigation" in the proposed amendments. The Board notes that the terms are used in other PCAOB auditing standards and generally refer to taking a closer look at a matter to determine a further course of action.⁶⁹ After considering the comments, the Board is adopting this requirement as proposed.

5. Obtaining Information at the Individual or Firm Level

See note to paragraph .06D of AS 2101 in Appendix 1

The amendments include a note to AS 2101.06D stating that information required to be provided to the lead auditor under AS 2101.06D may cover the other auditor's firm and engagement team members who are partners, principals, shareholders, or employees of the other auditor firm.

Some commenters on the proposing releases questioned the practicability of applying the requirements to individual engagement team members. Further, one commenter on the 2021 SRC specifically asked for clarification regarding the level (i.e., firm, individual, or both) at which the lead auditor is expected to apply the requirements in paragraph .06Da (obtaining an understanding of other auditors' knowledge and experience) *and* how to interpret the proposed note to paragraph .06D.

The definition of "other auditor" in the amended standards includes both an other auditor firm and individuals at that firm. The affirmations and descriptions required by the amendments could be prepared and provided by the other auditor firm and address all covered relationships. In our experience, firms typically have the necessary information available centrally, including information about processes for determining compliance with independence and ethics requirements, and about individuals at the firm, including their level of experience in applying the requirements. Obtaining from a firm a written affirmation or description that also encompasses relevant individuals at the firm would satisfy the requirement to obtain a written affirmation or description "from the other auditor" for those persons at that firm.

⁶⁹ See, e.g., paragraphs .17, .20–.21 of AS 2305, *Substantive Analytical Procedures* (investigation and evaluation of significant differences from expectations about assertions related to the financial statements).

C. PCAOB Registration Status of Other Auditors

See paragraph .06G of AS 2101 in Appendix 1

PCAOB Rule 2100, *Registration Requirements for Public Accounting Firms*, requires a public accounting firm to be registered with the PCAOB⁷⁰ if it: (a) prepares or issues any audit report with respect to any issuer, broker, or dealer or (b) plays a substantial role in the preparation or furnishing of an audit report with respect to any issuer, broker, or dealer.⁷¹ However, there have been examples of firms that played a substantial role but were not registered with the PCAOB.⁷²

The amendments provide that the lead auditor may use the work of an other auditor that plays a substantial role on the audit⁷³ only if the other auditor is registered with the PCAOB.⁷⁴ The provision is intended to promote compliance with Rule 2100 and thereby enhance audit quality, and it does not change the rule or the related definition of “play a substantial role” in Rule 1001(p)(ii). Several commenters supported the provision, and we are adopting it as proposed.

With regard to registration requirements more broadly, one commenter suggested – as an alternative to requirements concerning independence and ethics, and concerning knowledge, skill, and ability – that we require all audit firms “engaged in a public entit[y] assurance engagement” to be registered with the PCAOB. In the commenter’s view, this approach would provide a “basis for consistent application [of PCAOB standards] for firms registered with the PCAOB.” We are not taking the commenter’s suggestion because simply requiring firms to register (beyond the current registration requirements) would not address

⁷⁰ See also Section 102(a) of the Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”), 15 U.S.C. § 7212(a).

⁷¹ An other auditor that is not registered with the PCAOB (regardless of whether such auditor is required to be registered with the PCAOB) is nonetheless subject to PCAOB authority when it acts as a person associated with a registered public accounting firm. See Section 2(a)(9) of Sarbanes-Oxley, 15 U.S.C. § 7201(a)(9)); PCAOB Rule 1001(p)(i) (defining “person associated with a public accounting firm”); see also Sections 104(c)(1), 105(b)(1), and 105(c)(4) of Sarbanes-Oxley, 15 U.S.C. § 7214(c)(1), 15 U.S.C. § 7215(b)(1), and 15 U.S.C. § 7215(c)(4) (articulating that PCAOB authority extends to “persons associated with a registered public accounting firm” in connection with inspections, investigations, and sanctions, respectively).

⁷² See, e.g., *In the Matter of WWC, P.C.*, PCAOB Release No. 105-2022-006 (Apr. 19, 2022); *BDO Canada LLP (f/k/a BDO Dunwoody LLP)*, SEC AAER No. 3926 (Mar. 13, 2018); *KPMG Inc.*, SEC AAER No. 3927 (Mar. 13, 2018).

⁷³ See PCAOB Rule 1001(p)(ii).

⁷⁴ For audits in which the lead auditor divides responsibility for the audit with the referred-to auditor see AS 1206.06c in Appendix 2 of this release. See also discussion below in this appendix, in Section VI.B.4.

the need for change identified in this rulemaking. The shortcoming of this approach is demonstrated by the inspection deficiencies and enforcement cases described above in this release, which involve conduct by registered firms during audits involving other auditors.

D. Knowledge, Skill, and Ability of and Communications with Other Auditors

See paragraphs .06H and .16 of AS 2101 in Appendix 1

1. Knowledge, Skill, and Ability of Other Auditors

See paragraphs .06Ha-b and .16 of AS 2101 in Appendix 1

The amendments require that, with respect to each other auditor, the lead auditor 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, including their: experience in the industry in which the company operates; knowledge of the relevant financial reporting framework, PCAOB standards and rules, and SEC rules and regulations; and experience in applying the standards, rules, and regulations. The amendments also require the lead auditor to obtain a written affirmation from the other auditor that its engagement team members possess the knowledge, skill, and ability to perform their assigned tasks.⁷⁵

PCAOB standards have long recognized the importance of technical training and proficiency of the personnel performing the audit.⁷⁶ 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 existing PCAOB standards, in situations where the lead auditor supervises an other auditor under AS 1201, the knowledge, skill, and ability of engagement team members with significant engagement responsibilities should be commensurate with the assessed risks of material misstatement.⁷⁷ In situations where the lead auditor uses the other auditor's work and report under AS 1205, the lead auditor⁷⁸ is required under existing standards to make inquiries concerning the professional reputation of the other auditor.⁷⁹

⁷⁵ The written affirmation required by AS 2101.06Hb regarding the other auditor's engagement team members does not need to identify each member of the engagement team.

⁷⁶ See, e.g., AS 1010, *Training and Proficiency of the Independent Auditor*, and paragraphs .11–.12 of QC 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*.

⁷⁷ See AS 2301.05a.

⁷⁸ "Principal auditor" is the term used in rescinded AS 1205.

⁷⁹ See AS 1205.10.

The amendments build on and strengthen the existing provisions. Compliance with these amendments is not limited to preliminary engagement activities and should be reevaluated with changes in circumstances. The amendments seek to apply a balanced and practical approach by focusing the lead auditor's attention primarily on the knowledge, skill, and ability of the more senior engagement team members of the other auditor.

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, the knowledge, skill, and ability of the supervisory personnel include their experience in the company's industry and jurisdiction,⁸⁰ and knowledge of the relevant financial reporting framework, PCAOB standards and rules, and SEC rules and regulations. Lack of appropriate knowledge, skill, and ability by the other auditor's supervisory personnel can have an adverse effect on the overall quality of the audit.

Several commenters supported the proposed requirements, including the requirement to obtain a written affirmation from the other auditor that its engagement team members possess the knowledge, skill, and ability to perform their assigned tasks. One commenter asked the Board to consider providing that the lead auditor's procedures for obtaining an understanding of the knowledge, skill, and ability of the other auditor be scalable based on the considerations regarding sufficiency of participation in AS 2101.06A. The Board notes that the requirements in AS 2101.06A serve a different purpose: to increase the likelihood that the firm issuing the auditor's report meaningfully participates in the audit. The requirements regarding the knowledge, skill, and ability are designed to focus the lead auditor and other auditors on assigning qualified personnel at all levels of the audit engagement.

Another commenter suggested inserting a note after paragraph .06H that indicates the lead auditor's own experience working with the other auditor is relevant to the lead auditor's understanding of the other auditor's knowledge, skill, and ability. We agree with the commenter that the lead auditor's own experience with the other auditor may be a source of information about the other auditor's knowledge, skill, and ability. However, the amendments are designed to be principles-based to accommodate a variety of scenarios in practice, whereby differing types of information about other auditors can be available to the lead auditor. Therefore, beyond requiring the written affirmation described above, the amendments do not prescribe a particular set of procedures or sources of information for obtaining an understanding of the other auditor's knowledge, skill, and ability. The amendments allow the lead auditor to determine the nature and extent of its procedures in this area. After considering the comments, the Board is adopting the requirements as proposed.

⁸⁰ As discussed below, AS 2101.16 states that the auditor should determine whether specialized skill or knowledge is needed to perform appropriate risk assessments, plan or perform audit procedures, or evaluate audit results, and the amendments specify that such specialized skill or knowledge may include "relevant knowledge of foreign jurisdictions."

The amendments also add an explanatory phrase, “including relevant knowledge of foreign jurisdictions,” to AS 2101.16’s existing requirement that the auditor should determine whether specialized skill or knowledge is needed to perform appropriate risk assessments, plan or perform audit procedures, or evaluate audit results.⁸¹ Identifying whether there is a need for specialized skill or knowledge is logically a prerequisite to evaluating whether someone has that skill or knowledge. For example, a lead auditor in its home jurisdiction may not have a sufficient understanding of the business practices or legal requirements of a foreign jurisdiction to be able to execute the audit effectively. In these cases, the lead auditor may want to consider whether to engage an other auditor (e.g., from that jurisdiction) with relevant knowledge of the foreign jurisdiction to appropriately assess risk, plan or perform audit procedures, or evaluate audit results.

One commenter on the 2021 SRC stated that, if added focus on knowledge of foreign jurisdictions is needed, additional clarity should be provided as to when this knowledge is needed and how it should be obtained. Another commenter stated that consideration of relevant knowledge of foreign jurisdictions may be applicable only in certain circumstances but acknowledged the possible need for specialized knowledge of foreign jurisdictions because of the other auditor’s knowledge of the regulatory environment.

Similar to AS 2101.06Ha-b, the amendment in AS 2101.16 allows the auditor to determine the nature and extent of its procedures when determining whether specialized skill or knowledge is needed on the audit. After considering the comments, the Board is adopting the amendment as proposed.

2. Communication with Other Auditors

See paragraph .06Hc of AS 2101 in Appendix 1

The amendments to AS 2101 require the lead auditor to determine, in connection with using the other auditor’s work, that it is able to communicate with the other auditor and gain access to the other auditor’s audit documentation. The requirement is intended to help the lead auditor in identifying and addressing any communication or access issues early in the audit. For example, the lead auditor would consider whether it can have meaningful two-way communication with the other auditor⁸² and whether it needs to address any language

⁸¹ See amended paragraph .16 of AS 2101 in Appendix 1, which provides that “[t]he 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.”

⁸² See, e.g., AS 2110.49–.53 (describing discussions among key engagement team members regarding risks of material misstatement).

differences. In another example, the lead auditor would consider whether it can access the other auditor's documentation remotely.

The amendment also is based on the existing provisions of PCAOB standards that require the lead auditor to have access to the other auditor's documentation and obtain, review, and retain certain portions of it. As with the existing requirements, the amendments allow the lead auditor flexibility in determining the means of access (e.g., remotely or on-site).⁸³

If the lead auditor cannot obtain sufficient appropriate audit evidence because of restrictions on communicating with the other auditor or accessing its documentation, a limitation on the scope of the audit may exist. Under PCAOB standards, these circumstances may require the lead auditor to qualify the audit opinion or disclaim an opinion.⁸⁴

Those who commented on the proposed requirement in the 2016 Proposal and 2017 SRC viewed it as a clear requirement. Some commenters asked for examples of acceptable modes of communication between the lead auditor and the other auditor, and inquired whether e-mail communication would be acceptable. The Board notes that the form of communication between auditors (e.g., oral or written) depends on the circumstances of the audit and professional requirements (e.g., PCAOB standards require that certain communications between the lead auditor and other auditor be in writing⁸⁵). Although PCAOB standards do not prescribe a particular type of written communication (e.g., print or electronic), they require that audit documentation, in whatever form, contain sufficient information to enable an experienced auditor, having no previous connection with the engagement, to understand the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached.⁸⁶ In addition, the other auditor's audit documentation must be accessible by the lead auditor.⁸⁷ Further, audit documentation should demonstrate that the engagement complied with the standards of the PCAOB.⁸⁸

In light of the above discussion, the Board is adopting the amendment as proposed.

⁸³ See, e.g., rescinded AS 1205.12. See also AS 1215.18–.19.

⁸⁴ See AS 2810.35. See also paragraphs .05–.17 of AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances*, which contains requirements regarding audit scope limitations.

⁸⁵ See, e.g., AS 1215.19.

⁸⁶ See AS 1215.06a.

⁸⁷ See AS 1215.18, as amended.

⁸⁸ See AS 1215.05a.

E. 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”). In these circumstances, 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 should perform the procedures in paragraphs .11–.13 to determine the locations or business units where audit procedures should be performed.

In light of the rescission of AS 1205, we are amending AS 2101.14 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. The amendment to AS 2101.14, together with the amended supervisory requirements in AS 1201, is intended to require that the lead auditor play the central role in determining the scope of the audit.

One commenter on the 2021 SRC recommended that the Board remove the requirements in proposed AS 2101.14 with regard to referred-to auditors because these requirements are not consistent with the principles underlying dividing responsibility (i.e., the approach would diminish the line between assuming and dividing responsibility). The Board notes that the amendment to this paragraph is consistent with the relevant requirements in existing AS 2101.14 applicable to audits that involve divided responsibility. For audits involving referred-to auditors, new AS 1206 describes interactions, including communication of the lead auditor’s plan to divide responsibility, and other measures to assure the coordination of activities between the lead auditor and the referred-to auditor when dividing responsibility.⁸⁹

After considering the comments, we are adopting the amendment as proposed.

IV. SUPERVISING OTHER AUDITORS

A. Overview of the Supervisory Approach

The Board’s amendments are intended to improve the quality of audits that involve other auditors for whose work the lead auditor assumes responsibility by requiring, among other things, that the lead auditor supervise the other auditors under AS 1201, as amended.

Currently, the risk-based supervision approach described in AS 1201 does not apply to situations in which the lead auditor uses the work and reports of other auditors under AS 1205.

⁸⁹ See Section VI of this appendix.

AS 1205, which we are rescinding, requires the lead auditor⁹⁰ to perform certain procedures, when using the work and reports of other auditors, that are more limited in scope than those required by the supervision standard, AS 1201. The 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.⁹¹ The amendments also supplement the general supervisory requirements in AS 1201.05 by providing direction for applying these requirements in an audit involving other auditors.⁹²

AS 1201 currently sets forth the general framework for supervision of engagement team members, including the nature and extent of supervisory activities. The standard allows the engagement partner to seek assistance in fulfilling his or her supervisory responsibilities from appropriate engagement team members, which includes team members from other firms involved in the audit.⁹³ While AS 1201 describes supervisory *activities*, it does not, however, describe supervisory *procedures* or assign them to a particular member, or members, of the engagement team. Further, the standard does not differentiate between the supervisory responsibilities of engagement team members at the lead auditor and at the other auditor.

Under PCAOB standards, the audit firm that issues the audit report is responsible for making sure that sufficient appropriate audit evidence has been obtained, and appropriately evaluated, to support the opinion in the audit report.⁹⁴ Because of the lead auditor's central role in the audit, the amendments we are adopting require that certain supervisory *procedures* be performed by the lead auditor. These procedures are designed to improve the effectiveness of the lead auditor's supervision of the work of other auditors.

The amendments also are designed to be scalable by applying the existing principles in AS 1201, which are already familiar to auditors. When designing and performing supervisory activities the lead auditor determines 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.⁹⁵ For example, the extent of the lead auditor's supervision of the other auditors' work depends on, among other things, the risks of

⁹⁰ "Principal auditor" is the term used in AS 1205.

⁹¹ For situations in which the lead auditor divides responsibility for the audit with another accounting firm, see Appendix 2 of this release, which presents new AS 1206. 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 changes to Appendix B of AS 1105.

⁹² See AS 1201.07-.15.

⁹³ See AS 1201.04.

⁹⁴ See AS 2810 regarding evaluating the sufficiency and appropriateness of audit evidence.

⁹⁵ See AS 1201.07.

material misstatement to the company's financial statements and the knowledge, skill, and ability of the other auditors.⁹⁶

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 amendments. For procedures not assigned to the lead auditor under the amendments, the lead auditor may seek assistance from qualified engagement team members (including those at the other auditor) in supervising the work.⁹⁷ The approach to supervising other auditors under the amendments is consistent with, and takes into account, recent developments at some accounting firms that have been observed through the Board's oversight activities.⁹⁸

Many commenters on the 2021 SRC noted that communications between the lead auditor and other auditors are iterative throughout the audit. In addition, some commenters stated that it was not clear to them whether under the amendments in the 2021 SRC other auditors can provide input to the lead auditor on certain issues.

We agree with commenters that effective supervision by the lead auditor typically necessitates two-way communication with the other auditor. Similar to the amendments proposed in the 2021 SRC, the final amendments are designed to foster effective interaction by requiring the lead auditor to, as necessary, hold discussions with and obtain information from the other auditors to facilitate the performance of the supervisory procedures.⁹⁹

The amendments to AS 1201 do not include the statement contained in rescinded AS 1205.03 that "the other auditor remains responsible for the performance of his own work and for his own report." Nevertheless, the Board believes that supervision by the lead auditor does not relieve other auditors of their responsibilities, which include applying due professional care and complying with PCAOB standards. To reinforce this principle, the amendments add a statement to AS 1015, that other auditors are responsible for performing their work with due professional care.¹⁰⁰ This statement reminds other auditors of their responsibility to perform

⁹⁶ See AS 1201.06.

⁹⁷ See AS 1201.04.

⁹⁸ See discussion above in Section IV.A.2 in the main part of this release.

⁹⁹ See, e.g., note to AS 1201.08 and AS 1201.10 (requiring the lead auditor to discuss with the other auditor any changes to its planned audit procedures), both of which were originally introduced in the 2016 Proposal. In addition, the amendments include a reference to paragraphs .49–.53 of AS 2110, *Identifying and Assessing Risks of Material Misstatement* (in a footnote to AS 1201.08) to remind the lead auditor of certain other required interactions with the other auditor. See discussion below, in Section IV.B.1.

¹⁰⁰ See note to AS 1015.01 ("For audits that involve other auditors, the other auditors are responsible for performing their work with due professional care.").

work in compliance with PCAOB rules and standards.¹⁰¹ Commenters were supportive of this added statement, noting that it was clear and appropriate. That responsibility is further emphasized by (i) an amendment requiring an affirmation from the other auditor about its compliance with the lead auditor's instructions¹⁰² and (ii) an amendment regarding audit documentation requirements.¹⁰³ The overall responsibility for the audit under the amendments remains, however, with the lead auditor, as is the case under the existing standards.¹⁰⁴

B. Supervisory Procedures to Be Performed by the Lead Auditor

Under the amendments to AS 1201, the engagement partner remains responsible for the engagement and its performance. Accordingly, the engagement partner is responsible for proper supervision of the work of engagement team members, including the work of engagement team members outside the engagement partner's firm. In fulfilling his or her supervisory responsibilities, the engagement partner may seek assistance from appropriate engagement team members, including engagement team members outside the engagement partner's firm. Engagement team members who assist the engagement partner with supervision should exercise their supervisory responsibilities in accordance with AS 1201.

With respect to the lead auditor's supervisory procedures in the amendments, 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 planning and supervision, are eligible to perform such procedures. In addition, in multi-tiered audits, the lead auditor may seek assistance from a first other auditor in performing the supervisory procedures in the amendments.¹⁰⁵

To provide more specific direction for supervising the other auditors' work, the amendments to AS 1201 establish requirements for the lead auditor in the following areas:

- Informing other auditors of their responsibilities;

¹⁰¹ This amendment would not, of course, establish the sole responsibilities of other auditors. Like all auditors that participate in an audit performed under PCAOB standards, other auditors must comply with all applicable PCAOB standards. *See, e.g., PCAOB Rule 3100, Compliance with Auditing and Related Professional Practice Standards.*

¹⁰² *See AS 1201.11, which is discussed below in this appendix, in Section IV.B.3.*

¹⁰³ *See AS 1215.18, which is discussed below in this appendix, in Section VII.B.*

¹⁰⁴ To emphasize this point, the amendments add a footnote to AS 1015.01, referring to AS 2101 and AS 1201, which set forth the lead auditor's responsibilities for planning and supervising the other auditor's work.

¹⁰⁵ *See AS 1201.14.*

- Obtaining and reviewing a description of the audit procedures to be performed by other auditors;
- Obtaining and reviewing a written affirmation that other auditors performed their work in accordance with the lead auditor's instructions;
- Directing other auditors to provide specific documentation regarding their work; and
- Determining whether other auditors have performed the work assigned to them, and whether additional evidence should be obtained.

As noted in AS 1201.07, these requirements supplement the requirements in AS 1201.05. The requirements imposed by the amendments are described in new paragraphs AS 1201.08-.13 and discussed in more detail below.¹⁰⁶

1. 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 the nature, timing, and extent of the procedures to be performed, and other relevant matters.¹⁰⁷ 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.¹⁰⁸

To promote effective supervision of other auditors' work by the lead auditor, the amendments to AS 1201 specifically 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 unit¹⁰⁹ and the general type of work to be performed, which could range from a few specified audit procedures to a standalone audit); and

¹⁰⁶ The amendments also specify certain supervisory responsibilities in multi-tiered audits, as discussed in Section V below.

¹⁰⁷ See AS 1201.05a.

¹⁰⁸ 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 as to the scope of audit work.

¹⁰⁹ As discussed in Section III.E above, in multi-location engagements that involve other auditors, the lead auditor is required to determine locations or business units at which audit procedures should be performed.

- With respect to the work requested to be performed: the identified risks of material misstatement,¹¹⁰ tolerable misstatement,¹¹¹ and the amount (if determined) below which misstatements are clearly trivial and do not need to be accumulated.¹¹²

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 (some of whom also commented on the 2021 SRC) recommended that the lead auditor be required to communicate only the significant risks or only risks that are relevant to the other auditors' work. Some commenters agreed that the communication by the lead auditor to the other auditor about the scope of work, identified risks of material misstatement, and the amount (if determined) below which misstatements are clearly trivial and do not need to be accumulated, should be in writing.

In the 2021 SRC, we agreed 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. We therefore included in AS 1201.08b in the 2021 SRC the qualifying phrases "[w]ith respect to the work requested to be performed" and "to the consolidated financial statements that are associated with the location or business unit."¹¹³ These phrases remain in the final amendments. The amendments do not limit the lead auditor's communication to significant risks (as some commenters suggested) because doing so could

¹¹⁰ See AS 2110.49–.53 (referenced in a footnote to 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. An additional reference was added to the footnote reminding auditors of the requirements in AS 2110.59 regarding the auditor's responsibility to identify and assess the risks of material misstatement at the (consolidated) financial statement level and the assertion level.

¹¹¹ See AS 2105.08–.10 (referenced in a footnote to 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 above in this release, it is common for audits using other auditors to take place in different locations, including different countries.

¹¹² See AS 2810.10–.11 (referenced in a footnote to 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 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.

¹¹³ To align with similar language in AS 2101.11, the amendments have been revised from the 2021 SRC in AS 1201.08b(1) to change "the identified risks ... that are applicable to the location or business unit" to "associated with the location or business unit."

lead to inadequate testing of significant accounts and disclosures where a reasonable possibility of material misstatement to the financial statements exists.

Some commenters on the proposing releases 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. Further, a couple of commenters to the 2021 SRC recommended that the amendments not require the lead auditor to communicate identified risks of material misstatements that are applicable to the location or business unit. Instead, the commenters recommended a requirement that focuses the lead auditor on communicating identified risks to the consolidated financial statements and matters that would assist the other auditor in developing a more granular view of risks specific to the location or business unit.

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.¹¹⁴

We agree with commenters that input from other auditors may be necessary in identifying and assessing risks of material misstatement to the company's financial statements and developing an audit response. The amendments are designed to foster effective two-way communication by requiring the lead auditor to, as necessary, hold discussions with and obtain information from other auditors to facilitate the performance of the supervisory procedures.¹¹⁵ Notably, all key engagement team members, including those at the other auditor firms, are already required under existing standards 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.¹¹⁶ A reminder about these requirements is included in a footnote to AS 1201.08.¹¹⁷

We also agree with commenters that under the existing requirements the lead auditor identifies and assesses the risk of material misstatement at the level of the company's (consolidated) financial statements. An additional reference was added to the amendments

¹¹⁴ See AS 2110.49-53.

¹¹⁵ A note to AS 1201.08 provides 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 paragraph .08.

¹¹⁶ See AS 2110.49-.53.

¹¹⁷ See footnote 15 to AS 1201.08, citing AS 2110.49-.53, which require 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.

reminding lead auditors of the existing requirements of AS 2110.59 to identify and assess the risks of material misstatement at the financial statement level and assertion level.¹¹⁸

2. 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.¹¹⁹ 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.¹²⁰ In situations governed by AS 1205, the lead auditor is required to consider reviewing the audit programs of the other auditor.¹²¹

Similar to the proposed amendments in the 2021 SRC, the final amendments to AS 1201 require the lead auditor to obtain and review the other auditor's written description of audit procedures to be performed,¹²² 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.¹²³ Under these amendments, the lead auditor is 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.

The amendments are intended to promote proper supervision of the other auditor's work by the lead auditor and proper coordination of work performed by the lead and other auditor. Importantly, the 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 amendments provide that as the necessary extent of supervision increases, the

¹¹⁸ See footnote 15 to AS 1201.08.

¹¹⁹ See AS 2101.10.

¹²⁰ See AS 1201.05a(2).

¹²¹ See rescinded AS 1205.12.

¹²² See AS 1201.09.

¹²³ See AS 1201.10.

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.¹²⁴

Many commenters on the 2021 SRC recommended that these requirements for the lead auditor be more principles-based to better accommodate an iterative process of communication between the lead auditor and other auditors, and the use of communication technology. For example, some commenters indicated that planned audit procedures and related changes could be communicated through video conferencing and screen sharing instead of in writing. These commenters encouraged the Board to revise AS 1201.09 and .10 to make them more principles-based and to reflect the recent technological innovations in communication. A couple of commenters went further and recommended removing from the amendments the requirement to “obtain” the information. A couple of other commenters either recommended that the Board allow the lead auditor to apply judgment in determining what changes should be communicated in writing to the other auditor based on the lead auditor’s extent of supervision of the other auditor, or stated that the requirement could cause an other auditor that is not a member of the lead auditor’s network to be concerned about the confidentiality of its audit methodology.

In our oversight activities, the PCAOB has seen challenges in the coordination and communication between lead auditors and other auditors, particularly in coordinating their responsibilities for the planning and performance of audit procedures. Requiring that certain communications be in writing facilitates the supervision of the engagement by reducing the risk of miscommunication and lack of clarity about responsibilities.

The terms “obtain” and “in writing” do not mandate that auditor working papers be paper-based.¹²⁵ We believe that technological advances in communication including those discussed by commenters could improve the effectiveness and efficiency of the lead auditor’s supervision of other auditors, and we note that the amendments would not hamper the implementation of novel means of communication, including documentation and review.

For example, a lead auditor could meet with other auditors through video conferencing and could view and discuss documents that are shared by video screen. The lead auditor could also obtain documents by (i) receiving them via electronic mail or by downloading them via an electronic portal and could store them electronically or (ii) accessing the other auditor’s electronic working papers remotely. In any case, audit documentation supporting the lead auditor’s conclusions will need to contain a record that the lead auditor fulfilled its responsibilities under PCAOB standards, including reviewing the relevant documents and

¹²⁴ See note to AS 1201.09.

¹²⁵ See AS 1215.04 (audit documentation may be in the form of paper, electronic files, or other media).

meeting the requirements of other provisions and of other standards regarding matters such as determinations related to other auditors' work¹²⁶ and audit documentation.¹²⁷

As with paper-based documentation of the work of other auditors, the necessary level of detail of the other auditors' electronic documentation that is required to be requested, obtained, and reviewed by the lead auditor and the lead auditor's communication to the other auditors under the amendments will depend on the necessary extent of supervision of the other auditors' work by the lead auditor.

Separately, requiring the lead auditor to obtain a written description of audit procedures to be performed from the other auditor and communicate changes in writing to the other auditor not only allows the Board to fulfill its mandates of inspecting and potentially investigating the lead auditor's oversight of the other auditor's work but it is also important for an audit firm's audit quality reviews such as engagement quality reviews and internal inspections. For the reasons discussed above, we are adopting these requirements as proposed.

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

See paragraph .11 of AS 1201 in Appendix 1

As was proposed in the 2021 SRC, under the amendments the lead auditor is required to obtain and review a written affirmation as to whether the other auditor performed work in accordance with the instructions provided, as described in paragraphs AS 1201.08–.10, including the other auditor's use of applicable PCAOB standards in performing that work. If the other auditor has not performed the work in accordance with the instructions provided, the lead auditor is required to obtain and review 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.

This requirement is designed to provide information to the lead auditor about whether the other auditor performed work in accordance with the lead auditor's instructions, to inform the lead auditor of audit areas that may require additional attention, and to emphasize the other auditor's responsibility for properly planning and performing its work in compliance with PCAOB standards. It is also consistent with the existing practice of affirming in writing an other auditor's compliance with the lead auditor's instructions (e.g., in an "interoffice memorandum") at some audit firms. AS 1201.11 does not duplicate a requirement in

¹²⁶ See, e.g., AS 1201.13 (requiring the lead auditor to make certain determinations based on a review of the documentation provided by the other auditor, discussions with the other auditor, and other information obtained by the lead auditor).

¹²⁷ See, e.g., AS 1215.06 and AS 1215.18 as amended.

AS 1215.19 for the lead auditor to obtain, review, and retain certain documents relating to the other auditor's work.

Commenters on the 2021 SRC supported the written affirmation in AS 1201.11 as they believed it was a necessary requirement, and the Board is adopting it as proposed.

4. 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.¹²⁸ 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 specify the documents to be reviewed.) In addition, for audits involving other auditors, other 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.¹²⁹

As we proposed in the 2021 SRC, the amendments 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 of the other auditor. 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 and that supports the lead auditor's obligation to obtain sufficient appropriate audit evidence to provide a reasonable basis for its opinion.

The amendments also state that the documentation requested by the lead auditor from the other auditor depends 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 amendments, review of additional documentation (i.e., beyond the items listed in AS 1215.19) could be necessary to satisfy the lead auditor's supervisory responsibilities, for example, for work performed by less experienced other auditors, procedures in areas with heightened risks of material misstatement (including the other auditors' testing of controls that address the risks), or procedures to resolve significant issues arising during the audit. In directing the other auditor, the lead auditor could, for example, specify individual documents, types of documents, or documentation for audit areas that it intends to review.

One commenter generally supported the changes to proposed AS 1201.12 in the 2021 SRC that acknowledge the lead auditor's use of a risk-based approach in determining the documentation to review in performing its supervisory responsibilities. Another commenter

¹²⁸ See, e.g., AS 1201.05c.

¹²⁹ See, e.g., AS 1215.19 and rescinded AS 1205.12.

recommended that the amendments clarify that determining the necessary incremental documentation for the lead auditor to review (in addition to documents described in PCAOB standards) should be based on the facts and circumstances of an audit engagement. Another commenter on the 2021 SRC stated that privacy laws in certain jurisdictions may create obstacles for the transfer of documentation from the other auditor's country to the lead auditor's country. And another recommended clarifying that not all the documentation described in AS 1215.19 may be applicable in some situations. For example, in situations where the other auditor's involvement consists of only performing certain limited procedures (e.g., observing a company's physical inventory), certain documents in AS 1215.19 would not be applicable.

We considered these comments and determined that the requirements as proposed are sufficiently clear. We are therefore adopting the requirements as proposed. As noted previously, the amendments specifically state that the documentation requested by the lead auditor from the other auditor will be based on the necessary extent of supervision of the other auditor's work by the lead auditor (which depends on a number of factors, including risks of material misstatement and the knowledge, skill, and ability of the other auditor).

Additionally, with regard to privacy laws and potential challenges to accessing working papers, if effective methods of remote access to the working papers are available to the lead auditor, the amendments do not preclude the use of such methods. However, as is the case under the existing requirements, engagement team members from the lead auditor may need to travel to the country where the working papers are located to access the working papers and perform their review. The amendments do not change the existing requirement in AS 1215.19 for obtaining, reviewing, and retaining certain documentation related to the other auditor's work by the office of the firm issuing the auditor's report. If the lead auditor cannot obtain sufficient appropriate audit evidence, a limitation on the scope of the audit may exist. This may require the engagement partner to qualify the audit opinion or disclaim an opinion.¹³⁰

Finally, we agree with the commenter that in situations in which the other auditor only performs select procedures for the lead auditor, such as observing physical inventories, the lead auditor is not required to obtain all of the documents described in AS 1215.19, because those documents would not be applicable to the limited type of work performed by the other auditor. However, this does not reduce the need for the lead auditor to obtain documentation prepared by the other auditor that is sufficient to fulfill its supervisory responsibilities under AS 1201.¹³¹

¹³⁰ See AS 2810.35. See also paragraphs .05–.15 of AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances*.

¹³¹ See also AS 1215.A65.

5. Determining Whether the Other Auditor Has Performed the Work, and Whether Additional Evidence Should Be Obtained

See paragraph .13 of AS 1201 in Appendix 1

Under the general supervisory requirements of AS 1201, the engagement partner and his or her assistants should review the work of engagement team members to evaluate whether: (i) the work was performed and documented; (ii) the objectives of the procedures were achieved; and (iii) the results of the work support the conclusions reached.¹³² In the scenarios that are governed by rescinded AS 1205, the lead auditor should consider performing one or more specified procedures in addition to obtaining, reviewing, and retaining certain documentation of the other auditor's work.

Under the amendments, AS 1201.13 provides that the lead auditor should determine, based on a review of the documentation provided by the other auditor, discussions with the other auditor, and other information obtained by the lead auditor during the audit: (i) whether the other auditor performed the work in accordance with the lead auditor's instructions, including the use of applicable PCAOB standards; and (ii) whether additional audit evidence should be obtained by the lead auditor or other auditors. Notably, the amendments do not require that in all cases the lead auditor review all the documentation of the other auditor's work to determine whether the work has been performed. Rather, the lead auditor's determination should be based on the review of documents it requested from the other auditor under the amendments, discussions with the other auditors, and other information obtained during the audit.

The requirement to determine the need for additional evidence is intended to address circumstances that may be encountered in practice, including where the other auditors did not perform the procedures as instructed, or where sufficient appropriate audit evidence was not obtained. In those situations, the lead auditor would need to determine the appropriate next steps. For example, the lead auditor could determine that it is necessary for the lead auditor or the other auditor to perform additional audit procedures to address a previously unidentified risk of material misstatement or to obtain further audit evidence with respect to one or more locations or business units.¹³³

¹³² See AS 1201.05c. Additionally, AS 1201.05b requires the engagement partner or other supervisors to direct engagement team members to bring significant accounting and auditing issues to their attention so they can evaluate those issues and determine that appropriate actions are taken in accordance with PCAOB standards. That requirement also applies in the supervision of other auditors.

¹³³ See AS 1201.13. See also AS 2810.35 and .36 (which are referenced in a footnote to AS 1201.13b), requiring the auditor, among other things, to obtain further audit evidence if sufficient appropriate audit evidence has not been obtained.

Commenters did not oppose or suggest modifications to the proposed requirements in AS 1201.13, and we are adopting them as proposed.

V. MULTI-TIERED AUDITS

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

A. Supervisory Procedures in Multi-tiered Audits – Directing a First Other Auditor

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.

In addition to describing multi-tiered audits, the amendments 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 (i.e., procedures in paragraphs .08–.13 of AS 1201). Multi-tiered audits are described in the standard as 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.¹³⁴

Under the amendments, the lead auditor determines whether to seek assistance from a first other auditor in supervising one or more second other auditors, pursuant to factors in AS 1201.06.¹³⁵ Notably, however, the lead auditor is responsible for the supervision of the entire audit, including the supervision of all other auditors.

For example, a multi-tiered audit of a U.S. 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 amendments, the lead auditor could seek assistance from the U.K. firm in supervising the work of the second other auditor in Germany. In a more complex

¹³⁴ See footnote 19 to AS 1201.14.

¹³⁵ AS 1201.14.

structure, the lead auditor could seek assistance from a first other auditor in supervising the work of multiple second other auditors.

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 should be based on the factors for determining the extent of supervision in AS 1201.06 (see further discussion of the supervisory approach in Section IV.A).

The lead auditor's use of a first other auditor is entirely within the lead auditor's discretion. The lead auditor could decide not to seek assistance from the first other auditor in supervising the work of second other auditors where, for example, the first other auditor's knowledge of a particular industry, particular accounting or auditing area, or PCAOB rules and standards is insufficient to effectively review the work of the second other auditors.

A commenter on the 2021 SRC asserted that the description of multi-tiered audits as proposed in footnote 19 to AS 1201.14 does not provide sufficient context for circumstances that might give rise to multi-tiered audits. The commenter suggested an alternative description that would be based on the financial reporting structure of an entity, which the commenter viewed as more important to defining the concept of a multi-tiered audit than the audit structure.¹³⁶ Having considered the comment, the Board decided to adopt the amendments as proposed in the 2021 SRC. The description of multi-tiered audits in the amendments and the related requirements are discussed in the context of existing auditor responsibilities, to illustrate how the existing responsibilities apply when an audit includes one or more supervisory tiers.

Another commenter recommended that the description of multi-tiered audits be moved to the definitions section in Appendix A of AS 2101. The Board has decided not to relocate the description of "multi-tiered audits" to Appendix A of AS 2101, as it is not intended to be a defined term in the standards, but rather a description of a current practice.

B. Supervisory Procedures in Multi-tiered Audits – Evaluating a First Other Auditor's Supervision of a Second Other Auditor's Work

Under the amendments, the lead auditor is responsible for the supervision of the entire audit, including the supervision of all the other auditors' work. If a first other auditor performs supervisory procedures with respect to a second other auditor, the lead auditor is required to evaluate the first other auditor's supervision of the second other auditor's work.¹³⁷ If the first other auditor assists the lead auditor with performing the supervisory procedures described in AS 1201.14 (discussed in Section V.A above), the lead auditor is required to obtain, review, and

¹³⁶ The commenter provided the rationale that a multi-tiered audit may exist even if the first other auditor does not assist the lead auditor in supervising the work of a second other auditor.

¹³⁷ See AS 1201.14.

retain documentation identifying the scope of work to be performed by the second other auditor.¹³⁸ The requirements for the supervision of the other auditor's work in a multi-tiered audit also apply to audits in which there are multiple second other auditors.¹³⁹

Under the amendments, the lead auditor will consider the first other auditor's review of the second other auditor's work, and 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.¹⁴⁰ 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 and maintains documentation sufficient to understand the supervisory procedures performed with respect to the second other auditor, and if no unexpected issues arise during the audit.

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 (including the second other auditor's supervision of the work of further tiers of other auditors¹⁴¹) 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 1215.19.¹⁴² In other words, the amendments would not require the first other auditor to provide to the lead auditor multiple sets of the same type of documentation; for example, 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 auditor(s).

One commenter on the 2021 SRC supported the requirements and stated that they provided the right approach to multi-tiered audits. Another commenter indicated that the lead auditor should be able to place greater reliance on a first other auditor than the proposed requirements allowed, including relying on the first other auditor to determine the extent of supervision of second other auditors. In addition, this commenter stated that it disagreed with the requirement that the lead auditor should obtain and review documentation that identifies the scope of work for each location or business unit in a multi-tiered audit, although it agreed that the lead auditor needed such information in order to consider whether (and if so, the extent to which) it should be involved in the work of the second other auditor.

¹³⁸ See AS 1201.14.

¹³⁹ See also Section V.D below.

¹⁴⁰ See AS 1201.15.

¹⁴¹ See Section V.D below.

¹⁴² See note to AS 1201.14.

With regard to the comment that the lead auditor should be able to place greater reliance on a first other auditor, including relying on the first other auditor to determine the extent of supervision of second other auditors, the aim of this rulemaking is to increase the lead auditor's involvement in and evaluation of the other auditors' work. This includes the lead auditor's supervision of the work of second other auditors in multi-tiered audit scenarios. Allowing the lead auditor to simply rely on the first other auditor's supervision of a second other auditor, as recommended by the commenter, would not be consistent with this goal. As stated above, under the amendments, the lead auditor determines its extent of supervision of the second other auditor's work in accordance with the factors in paragraph AS 1201.06.

With regard to the comment that the lead auditor should not have to obtain and review documentation that identifies the scope of work for each location or business unit in a multi-tiered audit, we continue to believe that obtaining and reviewing such documentation is critical for informing the lead auditor's supervision of the other auditors' work. Supervision of the engagement, including the work of second other auditors, is the lead auditor's responsibility, and the lead auditor's knowledge of the scope of the work of second other auditors is necessary to effectively discharge that responsibility.

One commenter on the 2021 SRC expressed concerns about how the requirement to evaluate a first other auditor's supervision of a second other auditor would be operationalized, in particular what information would be taken into account in making the evaluation. This commenter recommended that requiring an up-front discussion between the lead auditor and the first other auditor about how second other auditors will be used and supervised would be more beneficial to audit quality. This commenter also stated that because it may not always be possible to observe the nature and extent of the review performed by the first other auditor, the standard should require the lead auditor to obtain a written affirmation from the first other auditor that the second other auditor has been supervised as agreed with the lead auditor (similar to the requirement in AS 1201.11).

When evaluating the first other auditor's supervision of the second other auditor's work, the lead auditor would not, in normal circumstances, be expected to reperform the first other auditor's supervisory procedures. Instead, the lead auditor would evaluate whether the first other auditor properly performed the assigned supervisory procedures with respect to the second other auditor, coordinated its work with the second other auditor, and resolved significant matters arising during the audit. The lead auditor's evaluation may include holding discussions with the first other auditor and reviewing the first and second other auditors' audit plans, written reports, or other documentation. Overall, the extent of the lead auditor's evaluation of the first other auditor's supervision depends on the nature of the work performed by the second other auditor, the results of the work, and the necessary extent of the lead auditor's supervision of the first other auditor's work.

We do not agree with the recommendation that the lead auditor obtain a written affirmation from the first other auditor that the second other auditor has been supervised as

agreed with the lead auditor. Under the amendments, the lead auditor is responsible for supervision of the entire engagement, including supervision of the first other auditor's supervision of second other auditors. An affirmation, by itself, may not provide information that is sufficient to discharge this responsibility. In some circumstances, for example, where the risks of material misstatements are higher, the lead auditor would need to evaluate more information than an affirmation to fulfill its responsibility to supervise the entire engagement, including the involvement of other auditors, to a necessary extent under PCAOB standards. Having considered the comments, the Board is adopting the amendments as proposed in the 2021 SRC.

C. Audit Planning in Multi-tiered Audits – Serving as Lead Auditor and Seeking Assistance from a First Other Auditor Related to a Second Other Auditor's Qualifications

As discussed in more detail in Section III.A.1 above, the 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.¹⁴³ 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, this consideration applies 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 a first other auditor in a multi-tiered audit.

Some commenters indicated that with respect to determining the sufficiency of participation of the lead auditor, the amendments regarding supervisory assistance from other auditors in a multi-tiered audit are clear and appropriate. There were no comments opposing these amendments, and the Board is adopting them as proposed.

Under the final amendments, the lead auditor may seek assistance from a first other auditor in performing procedures relating to a second other auditor's qualifications, including (i) compliance with independence and ethics requirements (under AS 2101.06D),¹⁴⁴ and (ii) knowledge, skill, and ability, and certain other items (under AS 2101.06H).¹⁴⁵

The amendments emphasize that the lead auditor remains responsible for determining the audit engagement's compliance with the independence and ethics requirements pursuant

¹⁴³ See AS 2101.06Ac.

¹⁴⁴ See AS 2101.06E.

¹⁴⁵ See AS 2101.06I. This provision does not change the existing requirement for the other auditors' documentation (including the second other auditor's) to be accessible to the office issuing the auditor's report. (See AS 1215.18 as amended.)

to AS 2101.06b.¹⁴⁶ If the lead auditor seeks assistance from the first other auditor, it should instruct the first other auditor to inform the lead auditor of the results of procedures, 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.¹⁴⁷ Further, allowing the lead auditor to seek assistance from a first other auditor regarding the second other auditor's knowledge, skill, and ability is consistent with the existing supervisory requirement in AS 1201.06, which provides that an auditor (first other auditor in this instance) should take into account the second other auditor's qualifications to determine the necessary extent of supervision of the second other auditor's work.¹⁴⁸

A couple of commenters agreed that the requirements applicable to multi-tiered audits relative to the planning procedures regarding a second other auditor's qualifications were clear and appropriate and supported the notion that the first other auditor is often best suited to perform these procedures. However, one commenter had concerns with the placement of the requirement related to knowledge, skill, and ability in a multi-tiered audit and suggested relocating it from AS 2101.06I to a note to AS 2101.06H but did not provide reasons for the concern. The same commenter also recommended that the first other auditor be expected to communicate to the lead auditor any concerns about the second other auditor's knowledge, skill, and ability.

With regard to the commenter's point on relocating the requirement to a note, the Board considered the comment but determined that moving the requirement to a note in AS 2101.06H is not necessary as its placement in a paragraph is sufficiently clear. Regarding a first other auditor's concerns about the second other auditor's knowledge, skill, and ability, a key element for determining the extent of supervision necessary is taking into account an engagement team member's knowledge, skill, and ability.¹⁴⁹ If the first other auditor had concerns regarding the knowledge, skill, and ability of a second other auditor, the first other auditor would take this into account and increase the extent of its supervision of the second other auditor's work. Additionally, under AS 1201.13, the first other auditor is required to determine – based on a review of the documentation provided by the second other auditor (pursuant to AS 1201.09–.12), discussions with the second other auditor, and other information obtained by the lead auditor during the audit – whether the second other auditor performed the work in accordance with the instructions and whether additional audit evidence should be obtained by the first other auditor, second other auditor, or the lead auditor. Having considered the comments received, the Board is adopting the requirements as proposed.

¹⁴⁶ *See id.*

¹⁴⁷ *See* AS 2101.06E.

¹⁴⁸ *See* AS 1201.06d.

¹⁴⁹ *See id.*

D. 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 V.A above, the business unit in Germany could acquire a company in Belgium, audited by a local firm, and the second other auditor in Germany could supervise and use the work of its Belgian counterpart (a third other auditor). As noted, the lead auditor could seek assistance from the U.K. firm in supervising the work of the second other auditor in Germany, which would include the German firm's supervision of the third other auditor in Belgium.

PCAOB standards are designed to work in situations involving multiple tiers of other auditors. While the amendments are focused on the planning and supervision responsibilities of the lead auditor, other requirements of PCAOB standards apply, and would continue to apply under the amendments, 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. No commenters expressed views different from the approach in the 2021 SRC regarding further tiers of other auditors. Therefore, the Board is adopting the requirements as proposed.

VI. DIVIDING RESPONSIBILITY FOR THE AUDIT WITH ANOTHER ACCOUNTING FIRM

See AS 1206 in Appendix 2

AS 1206, a new standard, specifically addresses the lead auditor's division of responsibility for the audit with another accounting firm ("referred-to auditor").¹⁵⁰ It carries forward, with certain modifications, relevant requirements for the divided-responsibility scenario that are in rescinded AS 1205.¹⁵¹ Currently, divided-responsibility engagements are relatively uncommon.¹⁵²

AS 1206 applies when the lead auditor divides responsibility for an audit of the financial statements and, if applicable, ICFR. Similar to AS 1205, the new standard does not require the

¹⁵⁰ Rescinded AS 1205 did not use the term "referred-to auditor." The definition of referred-to auditor is discussed above in this appendix, in Section II.C.

¹⁵¹ As discussed in the main part of the release (see Section II.B), AS 1205 also includes requirements for audits in which the auditor assumes responsibility for the work of another firm.

¹⁵² 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. See footnote 38 above.

lead auditor to supervise the referred-to auditor's work. Rather, each auditor is required to supervise its respective engagement team members in accordance with AS 1201.¹⁵³

These requirements apply in circumstances where the lead auditor decides to refer to the work of the referred-to auditor in its auditor's report. In such circumstances, the lead auditor does not assume responsibility for the work of the referred-to auditor. Instead, the lead auditor discloses the division of responsibility between the lead auditor and the referred-to auditor and the magnitude of the portion of the audit performed by the referred-to auditor.

Under AS 1206, both the lead auditor and referred-to auditor remain responsible for their respective audits. For example, both the lead auditor and referred-to auditor are required to comply with PCAOB standards when planning and performing their respective audits, including making materiality determinations, and issuing audit reports.¹⁵⁴

AS 1206 sets forth certain requirements for the lead auditor, which carry forward or strengthen the requirements of AS 1205. For example, AS 1206 requires the lead auditor to:

- Determine that audit procedures are performed, in coordination with the referred-to auditor, with respect to the consolidation or combination of the portions of the financial statements audited by the referred-to auditor;¹⁵⁵
- Obtain a written representation from the referred-to auditor regarding the referred-to auditor's independence under requirements of the PCAOB and the SEC;¹⁵⁶
- Determine, based on inquiries made to the referred-to auditor and other information obtained by the lead auditor during the audit, that the referred-to auditor is familiar with the relevant requirements of the applicable financial reporting framework, the standards of the PCAOB, and the financial reporting requirements of the SEC;¹⁵⁷ and

¹⁵³ With respect to supervision, if there is more than one referred-to auditor, the requirements in AS 1206.03–.09 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.

¹⁵⁴ See, e.g., AS 2101.11–.14 and AS 2105.10.

¹⁵⁵ See AS 1206.03 and AS 1205.10.

¹⁵⁶ See AS 1206.05a and AS 1205.10b.

¹⁵⁷ See AS 1206.06b and AS 1205.10c(ii)–.10c(iii).

- Disclose in its auditor's report (i) the division of responsibility between the lead auditor and the referred-to auditor and (ii) the magnitude of the portions of the company's financial statements audited by the auditors.¹⁵⁸
- Communicate to the referred-to auditor the decision to divide responsibility for the audit with the referred-to auditor¹⁵⁹ and determine a course of action when the lead auditor is unable to divide responsibility.¹⁶⁰

In addition, AS 1206 establishes new requirements. For example, AS 1206 requires the lead auditor to:

- Obtain a representation from the referred-to auditor that the referred-to auditor is duly licensed to practice under the laws of the jurisdiction that apply to the referred-to auditor's work;¹⁶¹
- If the referred-to auditor plays a substantial role in the preparation or furnishing of the lead auditor's report, determine whether the referred-to auditor is registered with the PCAOB;¹⁶²
- Disclose the name and refer to the report of the referred-to auditor in the lead auditor's report;¹⁶³ and
- Establish which auditor (lead auditor or referred-to auditor) has audited, and disclose in the lead auditor's report which auditor has taken responsibility for, the conversion adjustments in situations where the financial statements of the company's business unit audited by the referred-to auditor were prepared using a financial reporting framework that differs from the financial reporting framework used to prepare the company's financial statements.¹⁶⁴

Consistent with AS 1205, a note to AS 1206.01 requires that the engagement partner in a divided-responsibility scenario determine the sufficiency of his or her firm's participation in

¹⁵⁸ See AS 1206.08a and .08c, and AS 1205.07.

¹⁵⁹ See AS 1206.04 and AS 1205.10(c)(i).

¹⁶⁰ See AS 1206.07 (requiring the lead auditor, if it cannot divide responsibility, to plan and perform procedures necessary for it to issue an opinion, qualify or disclaim its opinion, or withdraw from the engagement) and AS 1205.11.

¹⁶¹ AS 1206.05b.

¹⁶² AS 1206.06c.

¹⁶³ AS 1206.08b.

¹⁶⁴ AS 1206.06d.

the audit to serve as the lead auditor. This requirement appears in AS 2101.06A–.06C, discussed in Section III.A above.¹⁶⁵

The 2016 Proposal retained the divided-responsibility approach that has long been permitted in PCAOB standards¹⁶⁶ and solicited views on whether this approach should be eliminated. Most commenters 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.¹⁶⁷ They stated that the lead auditor is ultimately responsible for the overall audit opinion and should not refer to other auditors.¹⁶⁸

Having considered the comments received, the Board has decided to retain the divided-responsibility alternative (with certain conditions set forth in the 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, the lead auditor may be unable to plan and supervise another auditor's work if the subsidiary audited by the other auditor is acquired by the lead auditor's audit client late in a fiscal year. In this situation, the lead auditor may be unable to gain access to people (e.g., subsidiary management, other auditor's personnel) and documentation (e.g., subsidiary records, other auditor's working papers).¹⁶⁹ As a result, the lead auditor may be unable to obtain sufficient appropriate audit evidence to support an unqualified audit opinion on the company's

¹⁶⁵ AS 2101.06A–.06C also address, among other things, the sufficiency-of-participation determination for audits subject to AS 1201.

¹⁶⁶ 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.

¹⁶⁷ See Section III.F.1 of the 2021 SRC for a more detailed discussion of comments received (e.g., concern that a lead auditor might divide responsibility to avoid liability for its work on the audit, concern that the effectiveness of audit committee oversight could be reduced if the audit committee has no relationship with the referred-to auditor, risk of leakage of market sensitive information may increase if the referred-to auditor is involved in a corporate transaction), including the Board's responses.

¹⁶⁸ 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 acknowledged that AICPA standards allow for divided responsibility. Transcript excerpts for these meetings are available in the docket for this rulemaking on the PCAOB's website, available at <https://pcaobus.org/Rulemaking/Pages/Docket042.aspx>.

¹⁶⁹ See also Section VII.A of this appendix for a discussion regarding investee financial statements audited by an investee's auditor.

consolidated financial statements and may determine to withdraw from the audit engagement or disclaim its opinion.

A. Objectives

See Appendix A of AS 2101 in Appendix 1 and paragraph .02 of AS 1206 in Appendix 2

AS 1206, unlike AS 1205 (which is being rescinded), discusses the following objectives of the lead auditor: (i) 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, internal control over financial reporting; and (ii) make the necessary disclosures in the lead auditor's report.¹⁷⁰

Some commenters suggested revising the proposed objectives. One commenter on the 2016 Proposal suggested that the objectives should include performing procedures necessary to make reference to the report of the referred-to auditor in the lead auditor's report, and making necessary disclosures in the report. Another commenter suggested broadening the objective to cover the assessment of the referred-to auditor's independence and competence and proper communication between the lead auditor and referred-to auditor to clarify roles and responsibilities.

Having considered the comments received, the Board believes that the recommended revisions relate to details of performance and reporting rather than to high-level objectives of the standard. It also notes that the lead auditor would effectively accomplish the objectives suggested by the commenters by performing the procedures described in AS 1206.¹⁷¹ Thus, the Board is adopting the standard's objectives as proposed.

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

1. Performing Procedures Regarding the Consolidation or Combination of the Financial Statements

See paragraph .03 of AS 1206 in Appendix 2

Under AS 1206.03, the lead auditor should determine that audit procedures are performed, in coordination with the referred-to auditor, to test and evaluate the consolidation

¹⁷⁰ See AS 1206.02.

¹⁷¹ See AS 1206.03–.07 regarding performing procedures with respect to the audit of the referred-to auditor, and AS 1206.08–.09 regarding making reference in the lead auditor's report. See also AS 1206.05–.06 regarding certain qualifications of the referred-to auditor, and AS 1206.03–.04 regarding coordinating certain procedures with, and communicating certain matters to, the referred-to auditor.

or combination of the financial statements of the business units¹⁷² audited by the referred-to auditor into the company's financial statements. Matters affecting the consolidation or combination of the financial statements typically include items that are not in the scope of the referred-to auditor's audit, such as elimination of intercompany transactions with the business unit audited by the referred-to auditor.

This provision in AS 1206 builds on and strengthens a requirement for the lead auditor in AS 1205.10 regarding adopting appropriate measures to assure the coordination of the lead auditor's activities with those of the referred-to auditor in order to achieve a proper review of matters affecting the consolidating or combining of accounts in the financial statements. Commenters did not address this proposed provision, and the Board is adopting it as proposed.

2. Communicating the Plan to Divide Responsibility

See paragraph .04 of AS 1206 in Appendix 2

Under AS 1206.04, the lead auditor is required to communicate to the referred-to auditor, in writing, its plan to divide responsibility for the audit with the referred-to auditor pursuant to PCAOB standards. A referred-to auditor who has been informed of the lead auditor's plan to divide responsibility will be able to take the necessary steps to ascertain the implications of participating in the audit of the company. For example, SEC rules require that the audit report prepared by the referred-to auditor be filed with the SEC.¹⁷³

This provision in AS 1206 builds on and strengthens a requirement for the lead auditor in AS 1205.10 regarding ascertaining that the referred-to auditor is aware of the divided-responsibility arrangement.¹⁷⁴ Commenters did not address this provision, and the Board is adopting it as proposed.

¹⁷² As stated in footnote 7 of AS 1206.03, the term "business units" includes subsidiaries, divisions, branches, components, or investments.

¹⁷³ See Regulation S-X Rule 2-05, 17 C.F.R. § 210.2-05, which requires that, in divided-responsibility scenarios, the referred-to auditor's report be filed with the SEC ("If, with respect to the examination of the financial statements, part of the examination is made by an independent accountant other than the principal accountant and the principal accountant elects to place reliance on the work of the other accountant and makes reference to that effect in his report, the separate report of the other accountant shall be filed."). The term "principal accountant" is used in this reference. See discussion above in Section II.C regarding whether the term "referred-to auditor" is aligned with the term "principal accountant" used by the SEC, noting that the definitions in this rulemaking do not affect the applicability of SEC terms or rules to audits involving other auditors or referred-to auditors, including the definition of "principal accountant."

¹⁷⁴ See AS 1205.10(c)(i).

3. Requesting a Written Representation Regarding Independence and Licensing

See paragraph .05 of AS 1206 in Appendix 2

AS 1206.05a provides that the lead auditor should obtain a written representation from the referred-to auditor that the referred-to auditor is independent of the audit client under the requirements of the PCAOB and SEC. This provision is designed to strengthen the existing requirements regarding the lead auditor's responsibilities with respect to the independence of the referred-to auditor.¹⁷⁵ Commenters did not address this proposed requirement, and the Board is adopting it as proposed.

AS 1206.05b provides that the lead auditor should obtain a written representation from the referred-to auditor that it is duly licensed to practice under the laws of the jurisdiction that apply to the work of the referred-to auditor. This requirement is not included in AS 1205. Commenters did not address this proposed requirement of AS 1206, and the Board is adopting it as proposed.

4. Conditions for the Lead Auditor to Divide Responsibility, and the Lead Auditor's Course of Action When It is Unable to Divide Responsibility

See paragraphs .06 and .07 of AS 1206 in Appendix 2

AS 1206 describes the (i) conditions that must be met for the lead auditor to divide responsibility with the referred-to auditor and (ii) lead auditor's course of action when it is unable to divide responsibility.¹⁷⁶ These provisions strengthen the requirements in AS 1205.11.¹⁷⁷ The requirements of AS 1206, which are discussed in more detail below, are designed to facilitate compliance with PCAOB and SEC independence requirements and PCAOB registration rules, and to reduce the likelihood of filing auditors' reports with the SEC that violate any relevant local licensing requirements.

¹⁷⁵ AS 1205.10 requires the lead auditor to "make inquiries" concerning the other auditor's independence, which inquiries "may include" procedures such as obtaining a representation from the other auditor that the other auditor is independent.

¹⁷⁶ See AS 1206.06 and .07.

¹⁷⁷ Under AS 1205.11, the lead auditor should appropriately qualify or disclaim its opinion on the consolidated financial statements if it concludes that it can neither assume responsibility for the work of the other auditor nor divide responsibility with the other auditor.

i. Conditions for the Lead Auditor to Divide Responsibility

Performed an Audit and Issued an Auditor's Report in Accordance with PCAOB Standards, and Was Registered with PCAOB (When Applicable)

Under AS 1206.06a, the lead auditor may divide responsibility with another accounting firm only if the referred-to auditor has represented that it has performed its audit and issued its auditor's report in accordance with PCAOB standards.¹⁷⁸ This provision, which is not included in AS 1205, is consistent with existing SEC rules and guidance with respect to the auditors' reports filed with the SEC.¹⁷⁹ Further, according to AS 1206.06c, the lead auditor may divide responsibility with another accounting firm that would play a substantial role in the preparation or furnishing of the lead auditor's report, or, if the referred-to auditor's report is with respect to a business unit that is itself an issuer, broker, or dealer, only if that firm is registered with the PCAOB.¹⁸⁰

AS 1206 mirrors current PCAOB registration requirements. It does not establish additional criteria for registering with the PCAOB or otherwise change the registration requirements. Specifically, AS 1206 will not allow the lead auditor to divide responsibility for the audit with an unregistered public accounting firm unless that firm is not required to be registered with the PCAOB under Sarbanes-Oxley Section 102(a) and PCAOB Rule 2100.

The standard the Board is adopting clarifies, in a footnote to paragraph .06, that if the referred-to auditor is not registered with the PCAOB, the requirement in AS 3101 regarding stating in the auditor's report that the auditor is registered with the PCAOB does not apply to the referred-to auditor's report.¹⁸¹ The same footnote also points out that disclosure in the referred-to auditor's report that a firm is not registered with the PCAOB (or omission of a

¹⁷⁸ 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*, apply to auditors' reports issued 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 applies to auditors' reports issued 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.

¹⁷⁹ See Regulation S-X Rule 2-02(b)(1), 17 C.F.R. § 210.2-02(b)(1); SEC, *Commission Guidance Regarding the Public Company Accounting Oversight Board's Auditing and Related Professional Practice Standard No. 1*, Release No. 34-49708 (May 14, 2004).

¹⁸⁰ See Section 102(a) of Sarbanes-Oxley, 15 U.S.C. § 7212(a); PCAOB Rule 2100, *Registration Requirements for Public Accounting Firms*; paragraph (p)(ii) of PCAOB Rule 1001 (defining the phrase "play a substantial role in the preparation or furnishing of an audit report").

¹⁸¹ See AS 3101.06 and .09g, and AS 2201.85A and .85Dd.

statement that the firm is registered) does not relieve that firm of its obligation to register when required. We received no comments on this provision and are adopting it as proposed.

Knowledge of Relevant Requirements and Standards

Under AS 1206.06b, the lead auditor may divide responsibility with the referred-to auditor only if the lead auditor determines, based on inquiries made to the referred-to auditor and other information obtained by the lead auditor during the audit, that the referred-to auditor is familiar with the relevant requirements of the applicable financial reporting framework, PCAOB standards, and SEC financial reporting requirements.

The final standard's formulation "is familiar with" was included in the 2021 SRC, modifying the earlier formulation "knows," to reflect the difference in the lead auditor's relationship with the referred-to auditor (for divided responsibility) and the other auditor (for supervision). As noted in the 2021 SRC, the lead auditor does not supervise the referred-to auditor, because the referred-to auditor is responsible for its audit of and audit report on the financial statements (and, if applicable, ICFR) of the company's business unit. The lead auditor does not take responsibility for the referred-to auditor's audit. In contrast, when an other auditor is involved in the audit, the lead auditor supervises the other auditor's work, takes responsibility for that work, and is therefore required to obtain a more in-depth understanding of the other auditors' knowledge, skill, and ability when establishing the necessary extent of supervision than for a referred-to auditor in a divided-responsibility audit.

Commenters did not address this amendment, and the Board is adopting it as proposed.

Financial Reporting Framework Used to Prepare the Company's and Business Unit's Financial Statements

Under AS 1206.06d, in relatively uncommon situations when the financial statements of the company's business unit audited by the referred-to auditor are prepared using a financial reporting framework that differs from the framework used to prepare the company's financial statements, the lead auditor may divide responsibility only if (i) either the lead auditor or the referred-to auditor has audited the conversion adjustments and (ii) the auditor's report of the lead auditor indicates which auditor audited the conversion adjustments. (AS 1205, which is being rescinded, does not explicitly address these situations.)¹⁸² The final standard's approach was proposed in the 2017 SRC, reversing the restriction in the 2016 Proposal that would not have permitted the division of responsibility in the audit of a company whose applicable

¹⁸² PCAOB staff analyzed Form 10-K and Form 20-F filings with the SEC for the twelve-month period ended April 30, 2022. This search identified 38 divided-responsibility opinions, three of which the lead auditor divided responsibility with another auditor when the company and a business unit prepared their financial statements under different financial reporting frameworks. These filings did not state which auditor audited the conversion adjustments.

financial reporting framework differs from that of its business unit.¹⁸³ We believe the resulting approach is practicable and balanced and are adopting the provision substantially as proposed in the 2017 SRC.

Commenters on the 2017 SRC largely agreed with the revised provision, although two commenters recommended revisions. One recommended an additional requirement, that the lead auditor document its basis for concluding that the auditor of the conversion adjustments has sufficient knowledge of both reporting frameworks. Another commenter asserted that the lead auditor's disclosure of another auditor's audit of conversion adjustments could be misconstrued as a disclaimer of responsibility for that work.

With regard to the first commenter's recommendation, the Board notes that a separate documentation requirement is unnecessary because the lead auditor's compliance with the requirements relating to the referred-to auditor's knowledge of the relevant requirements is already required to be reflected in audit documentation under the existing PCAOB standards.¹⁸⁴ With regard to the second commenter's argument, the Board notes that the required disclosure in the lead auditor's report would clearly identify the auditor that has taken responsibility for auditing the conversion adjustments and the PCAOB has inspection and enforcement authority over both firms.

Appendix B of AS 1206 provides 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).

ii. Lead Auditor's Course of Action When the Lead Auditor Is Unable to Divide Responsibility Under AS 1206

AS 1206.07 provides guidance for situations in which the lead auditor is unable to divide responsibility with another accounting firm. Such a situation may arise, for example, due to the lead auditor's concerns about the qualifications of the referred-to auditor. Concerns about the referred-to auditor's qualifications could encompass both competence and PCAOB registration status. The lead auditor may also have concerns about whether the referred-to auditor's audit was performed in accordance with PCAOB standards if, for instance, information comes to the lead auditor's attention that raises such doubt.

For situations in which the lead auditor is unable to divide responsibility for the audit with another accounting firm, paragraph .07 of AS 1206 describes the following alternatives for the lead auditor's course of action:

¹⁸³ See 2017 SRC at 25-26.

¹⁸⁴ See, e.g., AS 1215.05a (providing that audit documentation should "[d]emonstrate that the engagement complied with the standards of the PCAOB").

- Planning and performing procedures with respect to the portion of the company's financial statements covered by the other accounting firm's report that are necessary for the lead auditor to express an opinion on the company's financial statements and, if applicable, ICFR;
- Appropriately qualifying or disclaiming the lead auditor's report;¹⁸⁵ or
- Withdrawing from the engagement.

A commenter requested that the standard state that the circumstances described in AS 1206.07 exist in situations when the lead auditor originally expected to divide responsibility with the referred-to auditor but subsequently determined that it was no longer possible. This commenter also stated that AS 1206.07, as proposed, limits the lead auditor's course of action to the three options presented and recommended that another option be added whereby the work would be performed by another accounting firm.

The Board agrees that AS 1206.07 applies only in situations when the lead auditor originally expected to divide responsibility with another accounting firm but subsequently determined that dividing responsibility with that accounting firm was no longer possible. Further, the Board notes that the course of action suggested by the commenter (i.e., having another accounting firm perform the work) is already available to the lead auditor under AS 1206.07a, as a lead auditor that complies with the relevant requirements of PCAOB standards is permitted to plan and perform procedures with respect to the business unit itself, divide responsibility for that work with another referred-to auditor, or supervise and assume responsibility for the work of an other auditor.

No further comments were received on this topic and the Board is adopting the requirement substantially as proposed.

¹⁸⁵ AS 1206, in a note to paragraph .07b, requires the lead auditor to state the reasons for 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. A footnote to AS 1206.07 refers to the relevant requirements of AS 3105 and Appendix C of AS 2201.

C. Making Reference in the Lead Auditor's Report to the Referred-to Auditor's Audit and Report

See paragraphs .08 and .09 of AS 1206 in Appendix 2

1. Enhanced Requirements for Making Reference

Paragraphs .08 and .09 of AS 1206 establish requirements for making reference in the lead auditor's report to the audit and auditor's report of the referred-to auditor.¹⁸⁶ Because this rulemaking generally carries forward, with certain modifications, AS 1205's provisions for divided-responsibility audits, the requirements for making reference in AS 1206 are similar to the analogous provisions of AS 1205. For example, similar to AS 1205, AS 1206 requires that the lead auditor's report (or reports, if the lead auditor chooses to issue separate reports on the company's financial statements and internal control over financial reporting):

- Indicate clearly, in the Opinion on the Financial Statements and, if applicable, Internal Control over Financial Reporting and Basis for Opinion sections, the division of responsibility between the portion of the company's financial statements and, if applicable, ICFR, covered by the lead auditor's own audit and that covered by the audit of the referred-to auditor;¹⁸⁷ and
- Disclose the magnitude of the portion of the company's financial statements and, if applicable, ICFR, audited by the referred-to auditor (or by each of the referred-to auditors if there is more than one). This may be done by stating the dollar amounts or percentages of total assets, total revenues, or other appropriate criteria necessary to identify the portion of the company's financial statements audited by each of the referred-to auditors.¹⁸⁸

If the report of the referred-to auditor includes an opinion other than an unqualified opinion or includes explanatory language, AS 1206, similar to AS 1205, requires that the lead auditor make reference in the lead auditor's report to the departure from the unqualified opinion and its disposition, or the explanatory language, or to both, unless the matter is clearly

¹⁸⁶ In addition, Appendix B of AS 1206 includes examples of reporting by the lead auditor (Examples 1 through 4). The Board's consideration of certain aspects of the examples are discussed in this appendix in Sections VI.B.4.i and VI.C.3. In addition, the examples consider the requirements of AS 3101 and AS 3501. Those standards were approved by the SEC after the issuance of the 2016 Proposal. See SEC Release No. 34-81916 (Oct. 23, 2017).

¹⁸⁷ See AS 1206.08a.

¹⁸⁸ See AS 1206.08c. See also second note to AS 1206.01, which states when there is more than one referred-to auditor, the lead auditor must apply the requirements of AS 1206.03–.09 in relation to each of the referred-to auditors individually.

trivial to the company's financial statements.¹⁸⁹ AS 1206 does not require that the lead auditor's report make reference to critical audit matters (CAMs) of the referred-to auditor, as each auditor must determine whether there are any CAMs arising from its own audit under AS 3101.

A commenter questioned whether, under AS 1206.08c, the magnitude of the portion of the company's financial statements audited by the referred-to auditor needs to be disclosed for each referred-to auditor individually. The commenter asserted that in practice the lead auditors' reports generally disclose the magnitude of the referred-to auditors' portions of the company's financial statements, and if applicable ICFR, in combination (not for each referred-to auditor). The commenter therefore recommended that the Board modify the requirement in line with the commenter's understanding of current practice.

We believe that the lead auditor's report should disclose the magnitude of the portion of the company's financial statements and if applicable, ICFR, individually for each referred-to auditor. In addition to providing greater transparency to investors and other users of the lead auditor's report about accounting firms involved in the audit and their responsibilities, the individual disclosure approach is not inconsistent with divided-responsibility reporting observed in practice. Based on a staff analysis of SEC filings, most lead auditor opinions that refer to multiple referred-to auditors disclose the magnitude of the referred-to auditors' portions of the company's financial statements individually.¹⁹⁰ The amendments state in the second note to AS 1206.01 that the requirements in paragraphs .03–.09 must be applied to each referred-to auditor individually.

The same commenter suggested replacing the proposed "and" (before the phrase "other appropriate criteria") in the last sentence of AS 1206.08c with "or" to indicate that not all magnitude criteria need to be disclosed. The Board agrees that under AS 1206 the magnitude may be expressed by using the criteria listed in paragraph .08c, but does not require using all criteria. Complying with AS 1206 involves using criteria that are necessary to provide a clear and informative disclosure in the lead auditor's report of the magnitude of the portion of the company audited by the referred-to auditors, and that may require disclosure of more than one criterion in some cases. To enhance clarity, the Board has replaced the term "and" with "or" as suggested by the commenter.

¹⁸⁹ See AS 1206.09. See also note to paragraph .10 of AS 2810, *Evaluating Audit Results* (describing "clearly trivial").

¹⁹⁰ PCAOB staff analyzed Form 10-K and Form 20-F filings with the SEC for the twelve-month period ended April 30, 2022. This search identified 38 divided-responsibility opinions, two of which made reference to multiple-divided-responsibility audits. Both of those opinions presented the magnitude disclosures disaggregated.

The Board considered these comments and determined that the remaining requirements are sufficiently clear and is adopting them as proposed.¹⁹¹

2. Identifying the Referred-to Auditor by Name

To enhance the clarity of disclosure to investors and other users of the lead auditor's report, the Board is adopting a new requirement in AS 1206.08b to identify the referred-to auditor by name in the lead auditor's report. SEC rules already require that the auditor's report of the referred-to auditor be filed with the SEC, so the name of the referred-to auditor is already made public.¹⁹²

Three commenters on the 2016 Proposal and 2021 SRC objected to the proposed disclosure, because the reader can obtain the referred-to auditor's name from the referred-to auditor's report filed with the SEC or from Form AP filed with the PCAOB.¹⁹³ Having considered these comments, the Board notes that the new provision – which builds on the existing disclosure of referred-to auditor responsibilities in the lead auditor's report, without imposing any significant compliance burden on the lead auditor – will provide interested parties a more convenient mechanism for obtaining names of the referred-to auditors, whose responsibilities, but not names, have long been disclosed in the lead auditor's report.

3. Other Considerations Relating to Making Reference

Some commenters on the Proposal and the 2017 SRC suggested addressing, in the reporting examples provided in AS 1206, situations in which the lead auditor issues separate reports on the financial statements and ICFR. Having considered the comments received, the Board included in the 2021 SRC an example of separate financial statement reporting in Appendix B of AS 1206 (Example 2). The Board received no comments on this example and is adopting it as proposed. In addition, in the 2021 SRC, the Board modified the reporting examples to reflect the amendments to AS 3101 that were approved by the SEC after the issuance of the 2017 SRC.¹⁹⁴ The examples as adopted include these modified examples.

¹⁹¹ Paragraph .09 was modified from the version in the 2017 SRC by: using the terminology in AS 3101 (which was amended by the PCAOB in 2017); adding a footnote reference to the relevant requirements of AS 3101, AS 3105, and AS 2201; and referencing a footnote in AS 1206.06 that addresses certain situations where the referred-to auditor is not registered with the PCAOB (as discussed above in this appendix in Section VI.B.4.i).

¹⁹² See Rule 2-05 of Regulation S-X, 17 C.F.R. § 210.2-05.

¹⁹³ Registered public accounting firms must report to the Board on Form AP, pursuant to PCAOB Rule 3211, regarding the participation of other public accounting firms in the audit. Form AP disclosure applies to scenarios when responsibility for the audit is divided.

¹⁹⁴ See SEC Release No. 34-81916 (Oct. 23, 2017).

VII. OTHER MATTERS

A. 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 firm issuing the auditor's report on the company's financial statements 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 (i.e., investees' auditors). 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 auditor¹⁹⁵ using the work and reports of other auditors under AS 1205.

Under the amendments, in equity method investment situations, the investor's auditor would look to the requirements of Appendix B of AS 1105, *Audit Evidence*, 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.¹⁹⁶ Thus, under the amendments, the investor's auditor would be able, where appropriate, to use the work and report of the investee's auditor.

The amendments add to Appendix B of AS 1105 certain relevant provisions currently included in AS 1205,¹⁹⁷ to further guide auditors in equity method investment circumstances. First, the amendments refer to the independence of the investee's auditor as an item for the investor's auditor to consider in determining whether the investee's auditor's report is satisfactory. 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 amendments 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. AS 2101.06b requires the auditor to determine compliance with independence and ethics requirements.¹⁹⁸

¹⁹⁵ "Principal auditor" is used in AS 1205.

¹⁹⁶ See Appendix B of AS 1105. See also *Auditing Accounting Estimates, Including Fair Value Measurements and Amendments to PCAOB Auditing Standards*, PCAOB Release No. 2018-005 (Dec. 20, 2018).

¹⁹⁷ See AS 1205.10.

¹⁹⁸ 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).

Second, the amendments refer to the professional reputation or independence of the investee's auditor as an item for the investor's auditor to consider in determining whether it needs additional evidence regarding the investee's financial results. 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 amendments add the investor's auditor's "concerns about the professional reputation or independence of the investee's auditor" to the list of examples 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 amendments do 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, for example, to use its own staff to perform procedures or seek assistance from the investee's auditor and supervise the investee's auditor's work under AS 1201. The 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 new standard AS 1206 would apply.

Several commenters were supportive of the proposed amendments for investee auditors, with some noting that the requirements provide a reasonable approach, while not being too prescriptive to allow for the investor auditor to make judgments. One commenter suggested that the Board define the term "investee auditor" and clarify in the rule text that the investee auditor is not considered an "other auditor." This commenter stated that this point is explicit in the release but not apparent in the proposed amendments. Another commenter expressed concern that the proposed terms and definitions in the rulemaking, including the term "investee's auditor," are fairly prescriptive and may be out of date after the Board adopts a final standard.

The Board considered these comments in adopting the amendments. The term investee's auditor pertains to a concept that is not new and is consistent with the terminology already in the standard,¹⁹⁹ and the Board does not believe that the term should be revised or eliminated. With regard to the comment that the Board should define the term investee auditor and clarify that the investee auditor is not considered an other auditor, it is possible that an investor's auditor may decide that it is able to supervise an investee's auditor under AS 1201, having considered the factors in AS 2101.12. In that situation, the investee's auditor could be considered an other auditor under the amendments.

Another commenter suggested that, in the situation involving an investee's auditor, sufficient appropriate audit evidence cannot be obtained through simple evaluation of sufficiency of the investee's financial statements and results. This commenter suggested that additional procedures may be required, such as the investor's auditor obtaining an

¹⁹⁹ See AS 1105.B3, which uses the term "investee auditor's report."

understanding of the investee's control environment as well as performing an evaluation or assessment of prior audit risks and business, financial, and market risks, including how those risks have been managed by the investee. As noted in the 2021 SRC, 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 inform, direct, and review work performed by the investee's auditor or obtain information from investee management. Therefore, while obtaining an understanding of the investee's control environment may be beneficial in certain cases, access issues may prevent it.

Further, the SEC staff has previously clarified that ICFR of an equity method investee is not part of the investor's internal control over financial reporting²⁰⁰ and therefore not part of the assessments required under Sections 404(a) and 404(b) of the Sarbanes-Oxley Act of 2002. Lastly, depending on the financial reporting framework of the investee, financial and market risks may be required to be disclosed within the financial statements. The Board believes that these disclosure requirements, if complied with, should be sufficient in some cases of equity method investees to contribute to an investor's auditor obtaining sufficient appropriate evidence. The Board agrees with the commenter that there may be situations in which further understanding by the investor's auditor of ICFR or the risks of the investee would be necessary. The Board notes that the amendments are principles-based and can be used to appropriately determine the necessary procedures for obtaining sufficient appropriate audit evidence.

A commenter requested clarification regarding a statement made in the 2021 SRC that AS 2101.06b requires the investor's auditor to determine compliance with independence and ethics requirements of the investee's auditor. It is not the Board's intent to change practice with these amendments, but it should be noted that the investor's auditor remains responsible for determining compliance with independence and ethics requirements for the entire audit, including work performed by the investee's auditor. The Board believes that an investor's auditor should determine whether the report of the investee's auditor is satisfactory and may consider performing procedures, such as making inquiries as to the investee's auditor's independence in making this determination.

Footnote 1 to AS 1105.B1 discusses procedures that the investor's auditor may consider performing to determine whether the investee's auditor's report is satisfactory. One commenter suggested replacing the word "visiting" in the phrase "visiting the investee's auditor" with the phrase "interacting (e.g., using video conferencing technology or visiting the

²⁰⁰ See SEC Staff FAQ on <https://www.sec.gov/info/accountants/controlfaq.htm> – Question 2. Under this approach, while ICFR related to an investee's financial reporting is out-of-scope, internal control over financial reporting related to an investor's recording of amounts associated with its investment is in-scope.

other auditor) with.”²⁰¹ The commenter offered this alternate phrasing to recognize the current practice of using technology for remote access. Having considered the comment, the Board is adopting the amendments as proposed. The word “visiting” should not be interpreted as requiring a physical visit or as precluding a virtual visit through the use of technology. Additionally, the Board notes that the procedures in footnote 1 to AS 1105.B1 use the qualifier “may consider performing;” thus, the determination of the procedures to perform is at the discretion of the investor’s auditor.

Another commenter opined that the amendments do not adequately address the nature and extent of work to be performed by the investor’s auditor, including the lack of consideration of knowledge, skill, and ability of the investee’s auditor, and noted that the standard used “reputation” as a consideration in footnote 1 to AS 1105.B1. Access to the investee’s auditor is likely to impact an investor’s auditor’s ability to evaluate the knowledge, skill, and ability of an investee’s auditor. In addition, under the circumstances, inquiries about the reputation and standing of the investee’s auditor²⁰² may uncover issues regarding the professional competence of the investee’s auditor. Two commenters raised the issue of non-coterminous year ends, which one of the commenters characterized as “a common problem,” and noted a lack of clarity about the nature and extent of work to be performed by an investor’s auditor in this situation, particularly with respect to competence, independence, and oversight of an investee’s auditor. One of these commenters also raised the issue of differing reporting frameworks and auditing standards.

The Board notes that the amendments are based on certain principles relating to the auditor’s responsibility for obtaining sufficient appropriate audit evidence. The amendments are designed to be flexible, considering a variety of situations that exist in practice involving an investee’s auditor. For example, in situations of non-coterminous year-ends, U.S. GAAP and IFRS allow for a consistent time lag between the fiscal year-ends of the investor and its equity method investees, which time lag would be reflected in the financial statements of the investor.²⁰³ The amendments require obtaining sufficient appropriate audit evidence in support of the investee’s financial results, and provide examples of procedures that may need to be performed in addition to reviewing the investee’s auditor’s report. With regard to differing

²⁰¹ As proposed and as we are adopting, footnote 1 to AS 1105.B1 states: “In determining whether the report of the investee’s auditor is satisfactory for this purpose, the auditor may consider performing procedures such as making inquiries as to the professional reputation, standing, and independence of the investee’s auditor (under the applicable standards), visiting the investee’s auditor and discussing the audit procedures followed and the results thereof, and reviewing the audit program and/or working papers of the investee’s auditor.” (emphasis added).

²⁰² See footnote 1 to AS 1105.B1.

²⁰³ See Financial Accounting Standards Board Accounting Standards Codifications, Subtopic 323-10, *Investments—Equity Method and Joint Ventures*, paragraph 10-35-6. See also International Accounting Standards Board International Accounting Standard 28, *Investments in Associates and Joint Ventures*, paragraph 34.

auditing standards, the investor's auditor is responsible for planning and performing – in compliance with PCAOB standards – the audit of the investor's financial statements (and, if applicable, internal control over financial reporting), including determining what constitutes sufficient appropriate audit evidence.

After considering all of these comments, the Board is adopting the amendments as proposed.

B. Audit Documentation

See paragraphs .18–.19 to AS 1215 in Appendix 1

Under existing AS 1215.18, the office of the firm issuing the auditor's report is responsible for ensuring that all audit documentation sufficient to meet the relevant requirements is prepared and retained.

As noted above in Section IV.A of this appendix, the amendments reinforce existing responsibilities of the other auditor to perform work with due care and in compliance with PCAOB standards. Specifically with respect to audit documentation, an amendment to AS 1215.18 reiterates that other auditors must comply with existing documentation requirements, specifically 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. Additionally, the amendments to AS 1215.18–.19 conform terminology relating to the use of the newly defined term "other auditor."²⁰⁴

A commenter on the 2021 SRC was supportive of the changes proposed in AS 1215.18 while another commenter suggested that the term "other offices of the firm" be revised in paragraphs .18–.19 to use another term to clarify that this concept should be applied to offices that are not the office of the firm issuing the auditor's report. The Board considered this comment and determined that the requirements proposed are sufficiently clear, and is adopting the requirements as proposed.

C. Engagement Quality Review – Amendment to AS 1220

See paragraph .10a of AS 1220 in Appendix 1

Existing PCAOB standards specify certain procedures the engagement quality reviewer should perform in evaluating the significant judgments made by the engagement team and the related conclusions reached in forming the overall conclusion on the engagement and in

²⁰⁴ See Section II.C of this appendix, above. In footnote 4 of AS 1215.18, the final amendments do not include the proposed phrase "in certain circumstances" after the words "other related documents" because it is superfluous.

preparing the engagement report.²⁰⁵ In addition, the amendments to AS 1220 require the engagement quality reviewer, in an audit involving other auditors or referred-to auditors, to evaluate the engagement partner's determination that the participation of the 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 and, if applicable, ICFR.²⁰⁶

Some commenters supported the amendment, while others opposed it, contending that the sufficiency-of-participation determination is not always a significant judgment and thus does not always warrant evaluation by the engagement quality reviewer. Having considered the comments received, the Board is adopting the requirement as proposed. Although determining the sufficiency of a firm's participation in the audit might not always be difficult or complicated, the decision that the firm can serve as lead auditor is always a significant judgment because it affects whether it is appropriate for the firm to issue the audit report.²⁰⁷ Therefore, evaluating the sufficiency-of-participation determination is important for the engagement quality reviewer's conclusion about whether the lead auditor's report is appropriate in the circumstances of a particular audit.²⁰⁸

VIII. CONFORMING AMENDMENTS AND OTHER RELEVANT CONSIDERATIONS

This section of the appendix discusses conforming amendments and other considerations where significant comment was received as part of this rulemaking. Appendix 3 to this release includes conforming amendments discussed in this section and other conforming amendments to PCAOB auditing standards, auditing interpretations, attestation standards, rules, and Form AP.

A. Communications with Audit Committees

See paragraph .10e of AS 1301 in Appendix 3

The 2021 SRC proposed to conform terminology in paragraph .10d of AS 1301, *Communications with Audit Committees*, with new definitions. In particular, the standard would have used "other auditors" in lieu of "independent public accounting firms or persons, who are not employed by the auditor." Upon further consideration, the Board determined that the

²⁰⁵ See AS 1220.09.

²⁰⁶ The corresponding requirements for the engagement partner are in AS 2101.06A–.06C. The amendments added a reference to these requirements and to the definitions of lead auditor, other auditor, and referred-to auditor in AS 2101, in a footnote to AS 1220.10a.

²⁰⁷ See AS 2101.06A.

²⁰⁸ See AS 1220.12.

proposed amendment might not be consistent with the original intent of the requirement to communicate all participants in the audit to the audit committee.²⁰⁹

The change proposed in the 2021 SRC could have excluded, for example, individuals who work at shared service centers and are supervised by an other auditor, as these individuals would be subsumed by the replacement term “other auditor.” To avoid unintended outcomes, this adopting release does not amend AS 1301.10d.

Separately, we are making a conforming change to AS 1301.10e to add “referred-to auditors” to the phrase “if significant parts of the audit are to be performed by other auditors.” The 2017 SRC²¹⁰ restored the existing phrase in AS 1301.10e, “if significant parts of the audit are to be performed by [other auditors],” that would have been removed by the 2016 Proposal. No subsequent comment was received in this area, and the Board is adopting the amendment to AS 1301.10e as proposed in the 2017 SRC.

B. Certain Required Interactions with the Referred-to Auditor

See paragraph .53 of AS 2401 in Appendix 3

The amendments to paragraph .53 of AS 2401, *Consideration of Fraud in a Financial Statement Audit*, conform terminology by replacing “other independent auditor” with “other auditors or referred-to auditors.” The amendments also replace “subsidiaries, divisions or branches” with “locations or business units, where applicable.” Further, the amendments include two new footnotes that refer to the definitions of “engagement team” and “referred-to auditor” in Appendix A of AS 2101, as well as clarify the term “business units,” used in the revised paragraph.

A commenter stated that this amendment would go beyond current practice for the division of responsibility. Having considered the commenter’s view, the Board is adopting the amendments to AS 2401 substantially as proposed.²¹¹ The Board believes that the amendment does not substantively change the example in AS 2401.53, but merely updates the terminology, aligning it with other amendments in this release.

²⁰⁹ See *Auditing Standard on Communications with Audit Committee and Related Amendments to PCAOB Standards*, PCAOB Release No. 2012-004 (Aug. 15, 2012).

²¹⁰ See 2017 SRC at 37.

²¹¹ The final amendments include “locations or business units, where applicable,” instead of only the term “business units.”

C. Amendments Relating to Certain Inquiries and Procedures Concerning Another Auditor

Several PCAOB standards refer to AS 1205.10–.12 when describing certain inquiries and procedures concerning another auditor²¹² whose audit report is used as audit evidence in the audit of a company’s financial statement (such as the audit report of a service auditor or predecessor auditor). In the majority of these circumstances, the auditor whose report is used in this manner is neither supervised by the lead auditor under AS 1201 nor serving as another independent auditor under AS 1205.²¹³

These amendments are amending the standards that refer to rescinded AS 1205.10–.12 by incorporating the relevant statements from those paragraphs into the text of the standards, as was the approach in the 2016 Proposal. The Board discussed comments received on the 2016 Proposal in the 2017 SRC and made no modifications to the proposed amendments.²¹⁴

A commenter on the 2021 SRC believed that the conforming amendment to AS 2601.19 would result in a change to the meaning and related user auditor performance requirement. This commenter suggested revisions to the language to highlight that the user auditor “may give consideration to” performing the procedures. The Board believes that the conforming amendment does not change the meaning of the requirement, and that it is sufficiently clear.²¹⁵ The amendment states that “the user auditor should consider performing one or more of the [listed] procedures.” This language is incorporated in several locations, *e.g.*, AS 2201.B23; paragraphs .18–.19 of AS 2601, *Consideration of an Entity’s Use of a Service Organization*; footnote 8 to paragraph .12 of AS 2610, *Initial Audits—Communications Between Predecessor and Successor Auditors*; and AS 3105.55.

The Board is adopting the amendments as proposed.

D. Rescinding AI 10, Part of the Audit Performed by Other Independent Auditors: Auditing Interpretations of AS 1205

The amendments (i) rescind AI 10, the auditing interpretations of AS 1205; and (ii) carry forward, with modifications, as an amendment to AS 2110, a provision in AI 10 that the other accounting firm should consider inquiring of the lead auditor about matters that may be

²¹² Such inquiries include inquiring about professional reputation and reviewing the work of another auditor.

²¹³ Under rescinded AS 1205, for these circumstances the auditor who uses the audit may be in a position analogous to that of a principal auditor. *See, e.g.*, AS 1205.14.

²¹⁴ *See* 2017 SRC at 35.

²¹⁵ We do not view the phrase “should give consideration” in existing AS 2601.19 as being different from “should consider,” which is the terminology used in auditing and related professional practice standards as defined in PCAOB Rule 3101.

significant to the other accounting firm's own audit (e.g., executive compensation arrangements).²¹⁶

Situations in which the lead auditor divides responsibility for the audit with a referred-to auditor are governed by the new standard, AS 1206. The new standard requires, among other things, that the lead auditor communicate with the referred-to auditor and determine that audit procedures are properly performed, in coordination with the referred-to auditor, with respect to the consolidation or combination of the financial statements of the business units audited by the referred-to auditor into the company's financial statements. For situations in which the lead auditor supervises the work of the other accounting firm, the other auditor's inquiry of the lead auditor is addressed by existing standards.²¹⁷ For situations in which the lead auditor divides responsibility for the audit with the other accounting firm, an amendment to AS 2110 carries forward, with modifications, the existing requirement in AI 10 for the referred-to auditor's inquiries of the lead auditor as to matters that may be significant to the referred-to auditor's own audit.²¹⁸

Some commenters on the 2016 Proposal viewed rescinding AI 10 as appropriate, and some others suggested carrying forward all or certain portions of the guidance in AI 10, including the amendment we are making to AS 2110. A commenter on the 2021 SRC stated that the conforming amendment to AS 2110.11A was not consistent with the provisions of existing AS 1205.10 since, it asserted, AS 2110.11A goes beyond current practice. The Board is rescinding AI 10, as originally proposed. The AI 10 direction for the lead auditor is based on the limited procedures in AS 1205, which is rescinded by this release. The provision addressed to the referred-to auditor in AI 10.04–.07 is carried forward to AS 2110.11A, as noted above.²¹⁹

²¹⁶ See AI 10.04–.07; see also new paragraph, .11A to AS 2110 in Appendix 3. The modifications address the format and terminology.

²¹⁷ See, e.g., AS 2110.49–.51, which require discussion among engagement team members throughout the audit about significant matters affecting risks of material misstatement.

²¹⁸ The Board is correcting a footnote number in paragraph .28A of AS 2110. This footnote was incorrectly numbered as 16A in a previous rulemaking release, *Amendments to Auditing Standards for Auditor's Use of the Work of Specialists*, PCAOB Release No. 2018-006 (Dec. 20, 2018), and it is being changed to 16C to reflect correct sequential numbering of footnotes. This change does not affect the content of the footnote.

²¹⁹ In addition to the new paragraph, .11A, in AS 2110, see Appendix 3 of this release for technical amendments to (i) AS 2110.13 and .28A (changing the numbering of two footnotes, to eliminate duplication) and (ii) AS 2110.64 (adding a footnote reference to AS 2101.11 and .12, to highlight relevant existing requirements for multi-location engagements).

E. Interim Reviews

See paragraphs .18b, .39–.40, and .52 of AS 4105 in Appendix 3

The Board is adopting conforming amendments to AS 4105, *Reviews of Interim Financial Information*. The 2016 Proposal included conforming amendments to that standard²²⁰ and requested comment on whether additional changes to the standards were needed for reviews of interim financial information that involve other auditors or referred-to auditors.²²¹ Three commenters who responded to this question briefly expressed support for addressing interim reviews in the amendments but did not specify any recommended changes. Another commenter stated that any additional requirements should be scalable because the scope of an interim review is substantially less than that of an audit.

The 2017 SRC discussed the comments received on this topic, stated the Board's intent to adopt conforming amendments to AS 4105, and asked for any additional comment.²²² No further comments were submitted on this topic in response to the 2017 SRC or 2021 SRC.

Having considered the comments received, the Board is adopting conforming amendments to AS 4105 to appropriately reflect changes to other PCAOB standards in this rulemaking and preserve the scalable approach to interim reviews. The conforming amendments have been revised from the form in which they were proposed in 2016. As adopted, footnote 11 to AS 4105.18b clarifies that, if an accountant (i.e., auditor) who conducts a review of interim financial information obtains a report from another accountant engaged to conduct a review of interim financial information of significant components of the reporting entity or its other business units, the accountant that obtains the report is ordinarily in a position similar to that of, as applicable, (i) a lead auditor that obtains the results of the work of an other auditor (*see generally* AS 1201 (audit supervision) and AS 2101 (audit planning)) or (ii) an investor's auditor that obtains a report from an investee's auditor (*see generally* Appendix B of AS 1105 (audit evidence)).

²²⁰ See 2016 Proposal at A3-32.

²²¹ See Question 58 in the 2016 Proposal at A4-62.

²²² See 2017 SRC at 36.