SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–95159; File No. PCAOB–2022–01]

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

June 24, 2022.

Pursuant to Section 107(b) of the Sarbanes-Oxley Act of 2002 (''Act''), notice is hereby given that on June 24, 2022, 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.[1] 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.[2] 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.[3]

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 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. The Board 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, the Board 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. The Board 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

[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).

[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).

developments in this area, the Board 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. 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.[8] 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.[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.

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.

[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*).

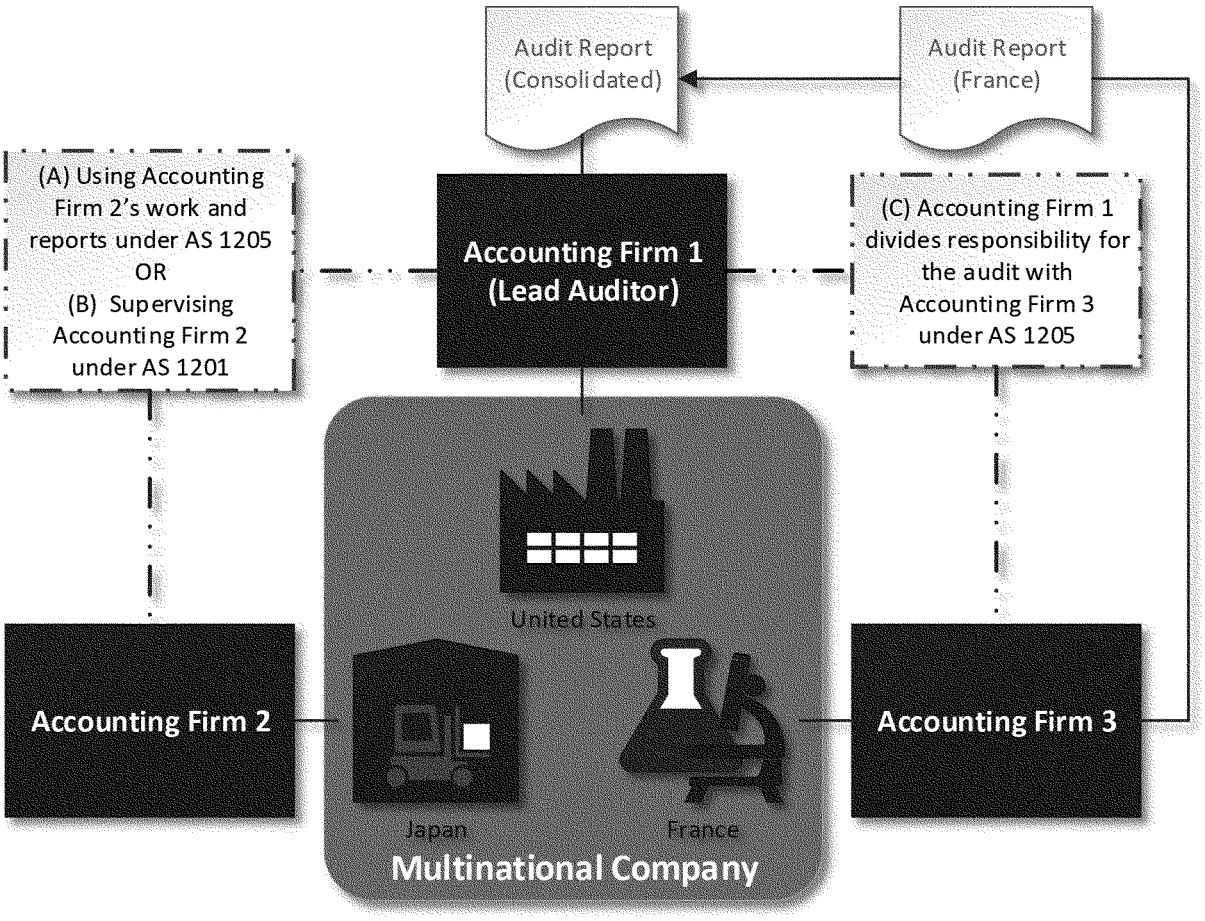
[9] In 1963, the American Institute of Certified Public Accountants (''AICPA'') issued a codification of auditing standards that included several paragraphs on using the work of other auditors or referred-to auditors. In 1971, the AICPA issued Statement on Auditing Procedure No. 45, *Using the Work and 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.

[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]

- 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 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

[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.

[14] *See* AS 1205.02.

[15] AS 1205.10.

[16] AS 1205.10.c.

weaknesses in internal control over financial reporting.[17]

• The lead auditor also should [18] 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;

• 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 responsibility and the magnitude of the portion of the financial statements audited by the other firm.[27]

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 and Assurance Standards Board (''IAASB'')—specifically, International Standard on Auditing (''ISA'') 600 [28]—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]

[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.

[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 CFR 210.2–05.

[25] AS 1205.06–.09.

[26] AS 1205.12.

[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 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).

[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 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.[32] 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 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]

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.

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]

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.[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

[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).

[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).

[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.

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 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.

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.

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.[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]

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.

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

[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.

[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.

[50] For data regarding deficiencies in audits that involve other auditors, see discussion 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.

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.[53] 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:

• *Planning the audit.* AS 2101, *Audit Planning,* as amended[54] 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)

[53] 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).

[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)

• 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 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 affirmations [56] 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)

• 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)

• 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;

[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'' as revised in this document.

[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).

[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 discussion below.

• 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.[61] 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.

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

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

for compliance with PCAOB standards.[62] The term ''engagement team'' is commonly used in PCAOB auditing standards but has not been defined. The definition of ''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.[63] As revised, the definition of ''engagement team'' includes:

(1) Partners, principals, and shareholders of, and accountants[64] 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.[65]

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.[66]

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
• Engagement partner • Personnel from the engagement partner's firm[68] who perform audit procedures on the audit • Personnel of accounting firms and individual accountants outside the engagement partner's firm who perform audit procedures on the audit (supervised under AS 1201)[72] • 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	• Auditor-engaged specialists.[67] • Engagement quality reviewer and those assisting the reviewer.[69] • Appendix K or filing reviewer.[70] • Service auditors of a third-party service organization.[71] • 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 consultants.[73]

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

[62] *See* AS 1201.03.

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

[64] *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.)

[65] The final amendments add the phrase ''in connection with the audit'' and replace ''assist their firm'' with ''assist that auditor'' for clarity.

[66] 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.)

[67] 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.)

[68] *See* AS 1210.

[69] AS 1220 applies to those persons.

[70] 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.

[71] 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.

[72] 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.)

[73] 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.*

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. 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.[74]

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.[75] The term ''lead auditor'' replaces the term ''principal auditor'' that is currently used in several PCAOB standards.[76] 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 firm[77] 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.[78]

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

Note: Individuals such as secondees[79] 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 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.[80]

The description of ''secondee'' was added to the proposed amendments in the 2021 SRC.[81] 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 guidance[82] 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

[74] *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.

[75] The amendments rescind AS 1205, which uses the term ''principal auditor.''

[76] *See* Other Related Amendments to PCAOB Auditing Standards.

[77] *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.

[78] *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.

[79] 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.

[80] *See, e.g.,* AS 2101.04.

[81] *See* 2021 SRC at A1–16 (proposed footnote 5 of AS 2101.A4).

[82] *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).

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 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.[83] 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 units[84] 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.[85]

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 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.[86] 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.

[83] 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.

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

[85] *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.

[86] 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.[87] 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 involving other auditors and referred-to auditors,[88] 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 audit[89] and for assigning tasks to and supervising engagement team members.[90]

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;
- *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.[91]

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.[92] 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, 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

[87] *See* AS 2101.05.

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

[89] *See* AS 2101.03.

[90] *See* AS 1015.06.

[91] 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.

[92] *See* 2017 SRC at 9.

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.[93] 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 ''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.[94] 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.[95]

Fifty-Percent Participation Threshold for Divided-Responsibility Audits

See Second Paragraph of .06A of AS 2101

For divided-responsibility audits,[96] the Board 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):[97]

> [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.[98] 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 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.[99] 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

[93] Such arrangements are sometimes referred to as ''letterbox audits.''

[94] 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.''

[95] 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.

[96] 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.

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

[98] 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.

[99] 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.

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 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 examples [100] 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.[101]
- *Procedures related to the consolidated financial statements,* such as audit procedures regarding the period-end financial reporting process [102] for the consolidated financial statements, and evaluation of the presentation of the consolidated financial statements, including the disclosures.[103]
- *Other procedures related to the overall evaluation of audit results,* such as performing overall analytical review procedures; [104] evaluating accumulated misstatements; [105] evaluating identified control deficiencies; [106] evaluating the qualitative aspects of the overall financial statements, including potential management bias; [107] evaluating conditions related to fraud risk assessment; [108] and evaluating the sufficiency and appropriateness of the audit evidence obtained. [109]

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.[110] 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 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.[111] 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 [112]

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.[113] 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.

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

[100] 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.

[101] *See* AS 2110.59b.

[102] *See* AS 2301.41.

[103] *See* paragraphs .30–.31 of AS 2810, *Evaluating Audit Results.*

[104] *See* AS 2810.07–.09.

[105] *See* AS 2810.10–.23.

[106] *See* AS 2201.62–.70.

[107] *See* AS 2810.24–.27.

[108] *See* AS 2810.28–.29.

[109] *See* AS 2810.32–.36.

[110] *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.

[111] *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.

[112] *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.

[113] *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.

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 affirmation [114] 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.[115] These amendments are meant to provide the lead auditor with information necessary for it to reevaluate compliance with independence and ethics requirements.[116] 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;* [117]
- 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; [118]
- 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; [119] 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.[120]

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.[121] 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 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.[122]

[114] 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).

[115] *See* AS 2101.06Dc, which applies to all affirmations and descriptions required by paragraph .06Db.

[116] *See* note to AS 2101.06b regarding reevaluating compliance.

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

[118] *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).

[119] 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.*

[120] *See* Rule 2–01(c)(3) of Regulation S–X, 17 CFR 210.2–01(c)(3).

[121] Concept Release: Potential Approach to Revisions to PCAOB Quality Control Standards, PCAOB Release No. 2019–003 (Dec. 17, 2019).

[122] 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).

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
- 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 client [123] 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.*[124] 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.[125]

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. 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.[126] 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 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

[123] 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.

[124] 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.

[125] *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).

[126] *See* AS 1205.10b.

taking a closer look at a matter to determine a further course of action.[127] 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 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 PCAOB[128] 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.[129] However, there have been examples of firms that played a substantial role but were not registered with the PCAOB.[130]

The amendments provide that the lead auditor may use the work of an other auditor that plays a substantial role on the audit[131] only if the other auditor is registered with the PCAOB.[132] 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

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.[133]

PCAOB standards have long recognized the importance of technical training and proficiency of the personnel performing the audit.[134] 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.[135] In situations where the lead auditor uses the other auditor's work and report under AS 1205, the lead auditor[136] is required under existing standards to make inquiries concerning the professional reputation of the other auditor.[137]

[127] *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).

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

[129] 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).

[130] *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).

[131] *See* PCAOB Rule 1001(p)(ii).

[132] 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.

[133] 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.

[134] *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.

[135] *See* AS 2301.05a.

[136] ''Principal auditor'' is the term used in rescinded AS 1205.

[137] *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,[138] 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 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.[139] 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

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 auditor[140] 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).[141]

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.[142]

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

[138] 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.''

[139] *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.''

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

[141] *See, e.g.,* rescinded AS 1205.12. *See also* AS 1215.18–.19.

[142] *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.

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 writing [143]). 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.[144] In addition, the other auditor's audit documentation must be accessible by the lead auditor.[145] Further, audit documentation should demonstrate that the engagement complied with the standards of the PCAOB.[146]

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 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.[147]

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

Supervising Other Auditors

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. AS 1205, which the Board rescinded, requires the lead auditor [148] 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.[149] 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.[150]

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.[151] 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.[152] 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.[153] 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.[154]

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

[143] *See, e.g.,* AS 1215.19.

[144] *See* AS 1215.06a.

[145] *See* AS 1215.18, as amended.

[146] *See* AS 1215.05a.

[147] *See* discussion below.

[148] ''Principal auditor'' is the term used in AS 1205.

[149] 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.

[150] *See* AS 1201.07–.15.

[151] *See* AS 1201.04.

[152] *See* AS 2810 regarding evaluating the sufficiency and appropriateness of audit evidence.

[153] *See* AS 1201.07.

[154] *See* AS 1201.06.

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.[155] 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.[156]

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.[157]

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.[158] This statement reminds other auditors of their responsibility to perform work in compliance with PCAOB rules and standards.[159] 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 instructions[160] and (ii) an amendment regarding audit documentation requirements.[161] The overall responsibility for the audit under the amendments remains, however, with the lead auditor, as is the case under the existing standards.[162]

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.[163]

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
- 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.[164]

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.[165] 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.[166]

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 unit[167] and the general type of

[155] *See* AS 1201.04.

[156] *See* further discussion above.

[157] *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.

[158] *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.'').

[159] 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.*

[160] *See* AS 1201.11, which is discussed below.

[161] *See* AS 1215.18, which is discussed below.

[162] 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.

[163] *See* AS 1201.14.

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

[165] *See* AS 1201.05a.

[166] 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.

[167] 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.

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,[168] tolerable misstatement,[169] and the amount (if determined) below which misstatements are clearly trivial and do not need to be accumulated.[170]

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, 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.'' [171] 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 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.[172]

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.[173] 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.[174] A reminder about these requirements is included in a footnote to AS 1201.08.[175]

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.[176]

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.[177] 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.[178] In situations governed by AS 1205, the lead auditor is required to consider reviewing the audit programs of the other auditor.[179]

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,[180] 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

[168] *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.

[169] *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.

[170] *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.

[171] 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.''

[172] *See* AS 2110.49–53.

[173] 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.

[174] *See* AS 2110.49–.53.

[175] *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.

[176] *See* footnote 15 to AS 1201.08.

[177] *See* AS 2101.10.

[178] *See* AS 1201.05a(2).

[179] *See* rescinded AS 1205.12.

[180] *See* AS 1201.09.

other auditor.[181] 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.[182]

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 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.[183] 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 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' work[184] and audit documentation.[185]

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.

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

[181] *See* AS 1201.10.

[182] *See* note to AS 1201.09.

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

[184] *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).

[185] *See, e.g.,* AS 1215.06 and AS 1215.18 as amended.

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.[186] 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.[187]

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 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.[188]

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.[189]

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

See Paragraph .13 of AS 1201

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.[190] 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

[186] *See, e.g.,* AS 1201.05c.

[187] *See, e.g.,* AS 1215.19 and rescinded AS 1205.12.

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

[189] *See also* AS1215.A65.

[190] *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.

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.[191]

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. [192]

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.[193] 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 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.[194] 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 evaluate the first other auditor's supervision of the second other auditor's work.[195] 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.[196] 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.[197]

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.[198] 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

[191] *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.

[192] *See* footnote 19 to AS 1201.14.

[193] AS 1201.14.

[194] 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.

[195] *See* AS 1201.14.

[196] *See* AS 1201.14.

[197] *See also* discussion below.

[198] *See* AS 1201.15.

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 auditors [199]) 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.[200] 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 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.[201] 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.

[199] *See* discussion below.

[200] *See* note to AS 1201.14.

[201] *See* AS 2101.06Ac.

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),[202] and (ii) knowledge, skill, and ability, and certain other items (under AS 2101.06H).[203]

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.[204] 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.[205] 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.[206]

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.[207] 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 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).[208] It carries forward, with certain modifications, relevant requirements for the divided-responsibility scenario that are in rescinded AS 1205.[209] Currently, divided-responsibility engagements are relatively uncommon.[210]

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.[211]

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

[202] *See* AS 2101.06E.

[203] *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.)

[204] See *id.*

[205] *See* AS 2101.06E.

[206] *See* AS 1201.06d.

[207] *See id.*

[208] Rescinded AS 1205 did not use the term ''referred-to auditor.'' The definition of referred-to auditor is discussed above in this release.

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

[210] 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.

[211] 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.

respective audits, including making materiality determinations, and issuing audit reports.[212]

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;[213]
- Obtain a written representation from the referred-to auditor regarding the referred-to auditor's independence under requirements of the PCAOB and the SEC;[214]
- 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;[215] 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.[216]
- Communicate to the referred-to auditor the decision to divide responsibility for the audit with the referred-to auditor[217] and determine a course of action when the lead auditor is unable to divide responsibility.[218]

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;[219]
- 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;[220]
- Disclose the name and refer to the report of the referred-to auditor in the lead auditor's report;[221] 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.[222]

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.[223]

The 2016 Proposal retained the divided-responsibility approach that has long been permitted in PCAOB standards[224] 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.[225] They stated that the lead auditor is ultimately responsible for the overall audit opinion and should not refer to other auditors.[226]

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).[227] 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 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.[228]

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

[212] *See, e.g.,* AS 2101.11–.14 and AS 2105.10.

[213] *See* AS 1206.03 and AS 1205.10.

[214] *See* AS 1206.05a and AS 1205.10b.

[215] *See* AS 1206.06b and AS 1205.10c(ii)–.10c(iii).

[216] *See* AS 1206.08a and .08c, and AS 1205.07.

[217] *See* AS 1206.04 and AS 1205.10(c)(i).

[218] *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.

[219] AS 1206.05b.

[220] AS 1206.06c.

[221] AS 1206.08b.

[222] AS 1206.06d.

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

[224] 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.

[225] *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.

[226] 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.*

[227] *See also* discussion below regarding investee financial statements audited by an investee's auditor.

[228] *See* AS 1206.02.

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.[229] Thus, the Board adopted the standard's objectives as proposed.

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 units [230] 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.

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.[231]

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.[232] 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 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.[233] 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.[234] These provisions strengthen the requirements in AS 1205.11.[235] 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.

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.[236] 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.[237] Further, according to AS 1206.06c, the lead auditor may divide responsibility with another accounting firm that would play

[229] *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.

[230] As stated in footnote 7 of AS 1206.03, the term ''business units'' includes subsidiaries, divisions, branches, components, or investments.

[231] *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.''

[232] *See* AS 1205.10(c)(i).

[233] 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.

[234] *See* AS 1206.06 and .07.

[235] 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.

[236] 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.

[237] *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).

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.[238]

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.[239] 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 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.)[240] 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 reporting framework differs from that of its business unit.[241] 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.[242] 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).

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

[238] *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'').

[239] *See* AS 3101.06 and .09g, and AS 2201.85A and .85Dd.

[240] 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.

[241] *See* 2017 SRC at 25–26.

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

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;[243] 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 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.[244] 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;[245] 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.[246]

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.[247] 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 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.[248] 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

[243] 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.

[244] 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).

[245] *See* AS 1206.08a.

[246] *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.

[247] *See* AS 1206.09. *See also* note to paragraph .10 of AS 2810, *Evaluating Audit Results* (describing ''clearly trivial'').

[248] 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.

''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.[249]

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.[250]

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.[251] 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 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.[252] 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 auditor[253] 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.[254] 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,[255] 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.[256]

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

[249] 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 regarding conditions for dividing responsibility).

[250] *See* Rule 2–05 of Regulation S–X, 17 CFR 210.2–05.

[251] 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.

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

[253] ''Principal auditor'' is used in AS 1205.

[254] *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).

[255] *See* AS 1205.10.

[256] *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).

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,[257] 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 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 reporting[258] 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 other auditor) with.''[259] 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 auditor[260] 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 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.[261] The amendments

[257] *See* AS 1105.B3, which uses the term ''investee auditor's report.''

[258] *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.

[259] 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).

[260] *See* footnote 1 to AS 1105.B1.

[261] *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.

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 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.'' [262]

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 preparing the engagement report.[263] 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.[264]

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.[265] 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.[266]

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 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.[267]

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 SRC [268] 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.

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

[262] *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.

[263] *See* AS 1220.09.

[264] 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.

[265] *See* AS 2101.06A.

[266] *See* AS 1220.12.

[267] *See* Auditing Standard on Communications with Audit Committee and Related Amendments to PCAOB Standards, PCAOB Release No. 2012–004 (Aug. 15, 2012).

[268] *See* 2017 SRC at 37.

''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.[269] 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 auditor[270] 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.[271]

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.[272]

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.[273] 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.

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).[274]

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.[275] 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.[276]

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.[277]

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 standard[278] 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.[279] 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.[280] 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

[269] The final amendments include ''locations or business units, where applicable,'' instead of only the term ''business units.''

[270] Such inquiries include inquiring about professional reputation and reviewing the work of another auditor.

[271] 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.

[272] *See* 2017 SRC at 35.

[273] 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.

[274] *See* AI 10.04–.07; *see also* new paragraph .11A to AS 2110 in this document. The modifications address the format and terminology.

[275] *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.

[276] 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 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.

[277] 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).

[278] *See* 2016 Proposal at A3–32.

[279] *See* Question 58 in the 2016 Proposal at A4–62.

[280] *See* 2017 SRC at 36.

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.[281] 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 reports filed by registered firms indicates that other auditors played a substantial role[282] in a small number of audits of brokers and dealers.[283] 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 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.

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

[281] 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 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).

[282] *See* PCAOB Rule 1001(p)(ii) (defining the phrase ''play a substantial role in the preparation or furnishing of an audit report'').

[283] 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.

from these improvements to PCAOB standards.[284]

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.[285] 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.

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.[286]
- 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.[287] Audits of such multinational businesses often require the participation of accounting firms other than the lead auditor and can often involve multiple other firms.[288] The use of other auditors is also more prevalent in audits of larger companies audited by larger accounting firms.[289] In addition, work performed by other auditors can comprise a significant share of a given audit.[290]

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.[291]

[284] *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).

[285] *See* 2016 Proposal at 30–49; 2017 SRC at 42; 2021 SRC at 62.

[286] *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.

[287] *See* 2016 Proposal at 6.

[288] *See id.* at 6 note 4.

[289] *See id.* at 7.

[290] *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).

[291] *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 type[292]		
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.[293]

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.[294] Their use is especially

[292] 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.

[293] 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.

[294] 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

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.[295] 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.

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.[296] For example, among all issuer audits involving the use of other firms, about 61 percent involved two or more other firms, 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.

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.

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

[296] 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.

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:[297]	
	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 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.

[297] 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.

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.

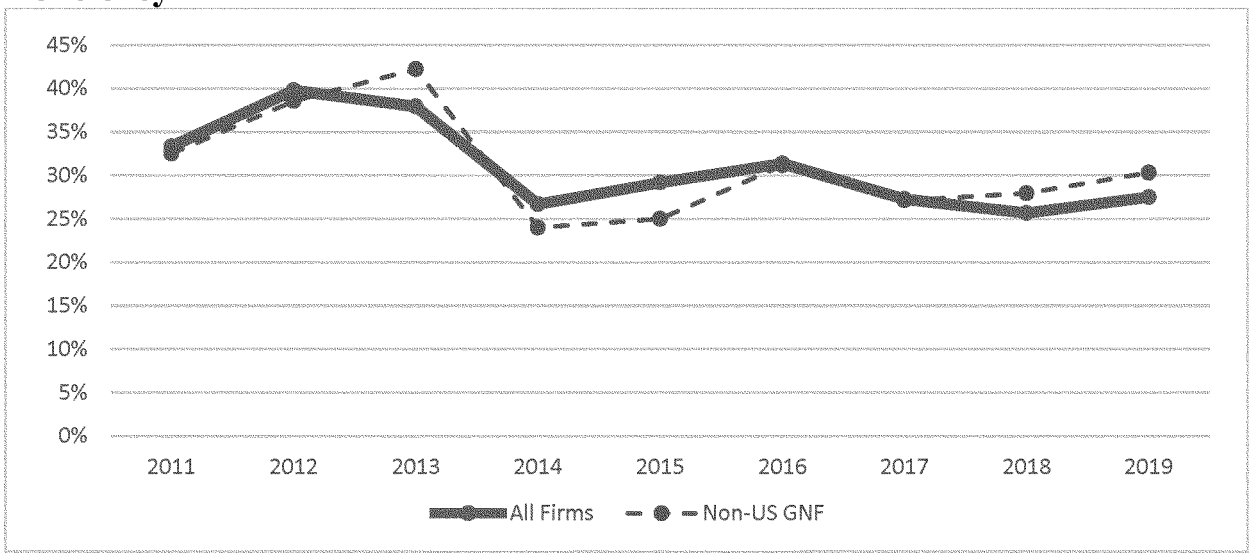
Deficiencies in Audits Involving Other Auditors

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 deficiencies [298] 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.

[298] 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



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.[299]

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.[300] 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.[301]

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.

Problem To Be Addressed

As discussed in the 2016 Proposal, incentive problems may arise from information asymmetry between investors and the lead auditor.[302] Specifically, in audits involving other auditors, a market failure[303] 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.[304]

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,

[299] *See* 2016 Proposal at 29–30 and notes 61–64; *see also* 2021 SRC at 55 and note 147.

[300] *See* 2016 Proposal at 29 note 61.

[301] *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.'').

[302] *See* 2016 Proposal at 30–33 and notes 66–73.

[303] The term ''market failure'' refers to a situation in which markets fail to function efficiently. *See* 2016 Proposal at 31 note 67.

[304] *See* 2016 Proposal at 37 note 78.

the other auditor, or (ii) monitor and review (*i.e.,* adequately supervise) the other auditor's work, leading to a moral hazard problem.[305]

Further, as discussed in the 2021 SRC, incentive problems may also arise from information asymmetry between lead auditors and other auditors.[306] 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.[307] 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.

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.[308] 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.[309]

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 work performed; and (v) determine whether the other auditor performed the work as instructed and whether additional audit evidence needs to be obtained.[310]

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 auditor and other auditors. The new requirements should strengthen the

[305] 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.

[306] *See* 2021 SRC at 61.

[307] *See* 2016 Proposal at 19–21.

[308] *See* 2016 Proposal at 35 note 75 (citing academic research).

[309] *See* 2021 SRC at 61 note 175.

[310] 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.

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.[311]

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.[312] 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.

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.[313] 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.[314]

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

[311] *See* 2016 Proposal at 37 note 78.

[312] *See* paragraphs .09–.24 of AS 1301, Communications with Audit Committees.

[313] *See* 2016 Proposal at 38.

[314] 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.

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.[315]

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.[316] 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 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.[317] 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 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.[318] 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.

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

[315] *See* 2016 Proposal at 40 note 80.

[316] *See* 2017 SRC at 14; 2021 SRC at 24.

[317] 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 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.

[318] The PCAOB's underlying standards governing the work of other auditors and referred-to auditors will similarly continue to apply to their work.

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.'' [319]
- ''The knowledge, skill, and ability of engagement team members with significant engagement responsibilities should be commensurate with the assessed risks of material misstatement.'' [320]
- 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.'' [321]

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.

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,[322] 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 the financial statements of the company and its business unit are prepared using different financial reporting frameworks.[323]

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.[324] 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.[325]

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.[326] 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 incurred primarily in circumstances involving a corresponding, and potentially larger, risk-mitigation benefit to investors.[327] 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

[319] AS 1015.06.

[320] Paragraph .05a of AS 2301, The Auditor's Responses to the Risks of Material Misstatement.

[321] Paragraph .15a of QC 20, System of Quality Control for a CPA Firm's Accounting and Auditing Practice.

[322] *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'').

[323] *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.

[324] *See* discussion above.

[325] *See* 2016 Proposal at 43.

[326] *See* Figures 2 and 3 above.

[327] *See* 2017 SRC at 40.

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.

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.[328] 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.

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

[328] 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.

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.[329] 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.

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.[330] 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.[331]

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.

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.

[329] 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.*

[330] *See* paragraphs .06A–.06C of AS 2101.

[331] *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/sagmeeting archive.* 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 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.[332] 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.[333] 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.

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.'' [334] 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.[335] 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.[336] As of the November 15, 2020 measurement date, PCAOB staff 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.[337]

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.[338] 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.

[332] *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.

[333] This provision is discussed in more detail above in relation to ''multi-tiered audits'' in this release.

[334] *See* Public Law 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.

[335] *See* 2016 Proposal at 51; 2017 SRC at 43; 2021 SRC at 66.

[336] 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.*

[337] *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.

[338] 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.[339] 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.[340] 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 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

[339] 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.

[340] *See* 2021 SRC at 65 note 183.

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 July 22, 2022.

For the Commission, by the Office of the Chief Accountant, by delegated authority.[341]

J. Matthew DeLesDernier,

Assistant Secretary.

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[341] 17 CFR 200.30–11(b)(1) and (3).