

# CAQ Alert 2024-01:

## Amendments to PCAOB Standards Related to Supervision of Other Auditors

January 2024

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# CAQ

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On June 21, 2022, the PCAOB issued [Release 2022-002](#), in which the Board adopted amendments to its auditing standards to strengthen requirements for planning and supervising audits involving accounting firms and individual accountants (“other auditors”) outside the accounting firm issuing the auditor’s report (the “lead auditor”). This alert has been prepared to support auditors in planning audits of fiscal years ending on or after December 15, 2024.

The amendments were designed to improve the quality of audits involving other auditors by increasing the lead auditor’s involvement in and evaluation of the work of other auditors, and to align the applicable requirements with the PCAOB’s risk-based supervisory standards. The Board also adopted a new auditing standard that applies when a lead auditor divides responsibility for an audit with another accounting firm (“referred-to auditor”).

Among the provisions in Release 2022-002 are the following:

- + Rescission of AS 1205, *Part of the Audit Performed by Other Independent Auditors*
- + Amendments to:
  - AS 2101, *Audit Planning*; and
  - AS 1201, *Supervision of the Audit Engagement*
- + Adoption of a new auditing standard, AS 1206, *Dividing Responsibility for the Audit With Another Accounting Firm*
- + Limited amendments to other auditing standards:
  - AS 1015, *Due Professional Care in the Performance of Work*;
  - AS 1105, *Audit Evidence*;
  - AS 1215, *Audit Documentation*; and
  - AS 1220, *Engagement Quality Review*

This Alert provides an overview of the provisions to assist auditors and other stakeholders with understanding and applying the standards and the key changes included in the amendments. This Alert is structured as follows:

- + Who will be affected and what is the effective date?
- + What are the objectives and reasons for the changes?
- + What are the key changes?
- + How might this impact you?
- + What can you do to prepare?
- + Resource links

## **WHO WILL BE AFFECTED AND WHAT IS THE EFFECTIVE DATE?**

The provisions apply to all audits conducted under PCAOB standards and are effective for audits of financial statements for fiscal years ending on or after December 15, 2024. The provisions will affect both lead auditors and other auditors.

While the effective date may seem like (almost) a year away, it's important to take action as part of the planning process for 2024 audits – well before the effective date – given the amendments relate to planning and supervising an audit.

## **WHAT ARE THE OBJECTIVES AND REASONS FOR THE CHANGES?**

Many companies have significant operations around the world. When auditing a multinational company, a lead auditor often needs participation of other firms or individual accountants to complete the audit. The use of other auditors is especially prevalent among audits of larger companies performed by larger accounting firms. PCAOB data indicate that other auditors are used in about 39 percent of audits performed by U.S. global network firms (GNFs) and about 58 percent of audits performed by non-U.S. global network affiliate firms.<sup>1</sup> Additionally, about 68 percent of Fortune 500 audits performed by U.S. global network firms involved other auditors, according to a PCAOB analysis of data from Audit Analytics and Standard & Poor's.<sup>2</sup>

Work performed by other auditors can account for a significant share of the audit. In audits involving other auditors selected by the PCAOB for inspection, other auditors on average audited between one-third and one-half of the total assets and total revenues of the audited company.<sup>3</sup> Without adequate supervision by a lead auditor, deficiencies in the work of other auditors can result in deficient audits. While many lead auditors properly supervise the use of other auditors, PCAOB inspectors have found that other firms need to strengthen their practices. Inspectors have identified audit deficiencies in the work of other auditors that the lead auditors did not identify or address.

The new provisions are intended to strengthen existing requirements and align the applicable requirements with the PCAOB's risk-based supervisory standards. They create a more uniform approach across the profession to the lead auditor's involvement in other auditors' work by providing increased specificity over the expectations related to the lead auditor's direction, supervision and review of the work of other auditors. Specifically, the provisions reinforce the importance of risk assessment in determining the level of involvement in other auditors' work; provide specificity for how to direct, supervise and review, including requiring certain two-way written communication between lead and other auditors (e.g., related to risk assessment, planned other auditor procedures, compliance with independence and ethics requirements); and set out minimum requirements for the lead auditor to demonstrate

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<sup>1</sup> Refer to PCAOB Other Auditors Adopting Release, page 28.

<sup>2</sup> Id.

<sup>3</sup> Id. at page 27.

their involvement in other auditors' work, including the specific audit documentation that should be obtained and reviewed by the lead auditor.

## WHAT ARE THE KEY CHANGES?

### Terminology changes

AS 1205 uses the term *principal auditor* to describe the auditor who is reporting on the financial statements and the term *other auditor* to describe an auditor other than the principal auditor, with responsibility for reporting on the financial statements of a component included in the financial statements audited by the principal auditor. PCAOB Release 2022-002 defines new terms for auditors serving in those roles. For engagements involving multiple accounting firms, the new and amended auditing standards use the following terms:<sup>4</sup>

- + *Lead auditor* - The registered public accounting firm issuing the auditor's report on the company's financial statements and, if applicable, on internal control over financial reporting (also referred to as the "engagement partner's firm"). Additionally, the engagement partner and 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 planning or supervisory responsibilities on the audit.
- + *Referred-to Auditor* - A public accounting firm, other than the lead auditor, that performs an audit of the financial statements and, if applicable, on internal control over financial reporting, of one or more of the company's business units and issues an auditor's report to which the lead auditor makes reference in the lead auditor's report on the company's financial statements and, if applicable, on internal control over financial reporting.
- + *Other Auditor* - 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 (also refers to such an engagement team member's firm).

### Lead auditor's direction, supervision and review of other auditors

The amendments place greater emphasis on the lead auditor's direction, supervision and review of other auditors, reinforcing that the lead auditor's involvement is commensurate with the risks of material misstatement associated with the component and prompting the lead auditor to focus on the areas of greatest risk.

#### *Sufficiency of lead auditor's participation*

The amendments require the lead auditor to determine whether their own firm's participation is sufficient to carry out the responsibilities of

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<sup>4</sup> Refer to AS 2101, Appendix A, as amended.

lead auditor. AS 2101, as amended, provides considerations involved in making that determination. With respect to an audit that divides responsibility with referred-to auditors, the amendments indicate that participation of the engagement partner's firm ordinarily is not sufficient for it to serve as lead auditor if the referred-to auditors, in the aggregate, audit more than 50 percent of the company's assets or revenues.

#### *Knowledge, skill and ability of other auditors*

The amendments give greater specificity in relation to understanding the knowledge, skill, and ability of the other auditors' team members, with particular focus on those who assist the lead auditor with planning or supervision. The amendments 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.

#### *Multi-tiered audits*

The amendments formalize requirements for multi-tiered audits, which are audits in which the engagement team is organized in a multi-tiered structure (e.g., whereby a first other auditor assists the lead auditor in supervising a second other auditor or multiple second other auditors). When the engagement team takes a multi-tiered approach, the amendments require the lead auditor to:

- + Obtain, review, and retain documentation identifying the scope of the work to be performed by the second other auditor (when communicated by the first other auditor); and
- + Evaluate the first other auditor's supervision of the second other auditors' work and consider this when determining their own approach to direction, supervision and review of the second other auditor's work.

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

#### **Increased requirements to assess compliance with independence and ethics requirements**

The amendments require the lead auditor to understand each other auditor's knowledge of SEC independence requirements and PCAOB independence and ethics requirements and their experience in applying them.

The amendments also require the lead auditor to obtain and review (1) written affirmations regarding the other auditors' policies and procedures about the relevant requirements and compliance with them, (2) descriptions of certain auditor-client relationships related to independence, and (3) written affirmation about whether the other auditor is in compliance with relevant independence and ethics requirements with respect to the audit client, and, if not, a written

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description of the nature of noncompliance. Changes related to independence and ethics matters are required to be shared between the lead auditor and other auditors and updated as necessary.

#### Greater specificity on two-way communications

The amendments are specific on what must be communicated between the lead auditor and other auditors, and which communications must be in writing.

AS 2101, *Audit Planning*, as amended, includes the following communication requirements:

- ✦ When determining the engagement's compliance with independence and ethics requirements in audits involving other auditors, the lead auditor should:
  - Obtain an understanding of the other auditor's (1) knowledge of SEC independence requirements and PCAOB independence and ethics requirements and (2) experience in applying the requirements. (AS 2101.06Da)
  - Obtain and review **written** affirmations regarding (1) the other auditor's policies and procedures regarding maintaining compliance with 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 describes the nature of any instances of noncompliance; 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))

With respect to the other auditor's knowledge, skill, and ability, the lead auditor should:

- 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: (1) experience in the industry in which the company operates; and (2) knowledge of the relevant financial reporting framework, PCAOB standards and rules, and SEC rules and regulations, and their experience in applying the standards, rules, and regulations. (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)

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- Determine that it can communicate with other auditors and gain access to their audit documentation. (AS 2101.06Hc)

AS 1201, *Supervision of the Audit Engagement*, as amended, includes the following communication requirements of the lead auditor:

- + Inform other auditors **in writing** 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, including the use of PCAOB standards, if the other auditor has not, a description of the nature of, and explanation of the reasons for, the instances where the work was not performed in accordance with the instructions, including (if applicable) a description of the alternative work performed. (AS 1201.11)

When the lead auditor divides responsibility for the audit with a referred-to auditor, new auditing standard AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*, includes the following communication requirements:

- + 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)

### Other changes

While most of the changes made by PCAOB Release No. 2022-002 involve amendments to AS 1201 and AS 2101, and the new standard AS 1206, limited amendments were also made to the other auditing standards, as follows:

- + AS 1015, *Due Professional Care in the Performance of Work*, was amended to explicitly require other auditors to perform their work with due professional care.
- + AS 1105, *Audit Evidence*, Appendix B, was amended to require consideration of whether additional evidence is needed about the valuation of investments based on the investee's financial results because of concerns regarding the investee auditor's professional reputation or independence.
- + AS 1215, *Audit Documentation*, was amended to require the other

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auditor to comply with the standard, including with respect to the documentation the other auditor makes accessible to the office issuing the auditor's report.

- + AS 1220, *Engagement Quality Review*, was amended to require the engagement quality reviewer to evaluate the engagement partner's determination that is it appropriate to serve as lead auditor and to report as such on the company's financial statements and, if applicable, internal control over financial reporting.

### **HOW MIGHT THIS IMPACT YOU?**

- + The provisions will affect both lead auditors and other auditors.
- + The level of involvement and effort by the lead auditor is expected to increase.
- + The impact at the individual engagement level will vary in significance depending on the audit structure, the knowledge, skill, and ability of the other auditors involved and the existing extent of the lead auditor's direction, supervision and review.
- + Overall, the changes will likely result in increased audit effort and cost by both lead auditors and other auditors. The increased effort is expected to be driven by an increase in the nature and frequency of interactions and the extent and documentation of information shared between lead and other auditors.
- + Documentation is expected to increase related to the lead auditor's (1) evaluation of the sufficiency of their involvement to carry out the responsibilities of lead auditor, (2) direction and supervision of, and communications with, other auditors and (3) review of specified documentation of the work performed by other auditors.
- + Documentation will likely increase related to the requirement for the other auditor to comply with AS 1215, *Audit Documentation*, including the documentation the other auditor makes accessible to the office issuing the auditor's report.
- + The impact of the changes will likely be greater when the lead auditor is using the work of an other auditor outside the lead auditor's network.
- + The impact of the changes will likely be greater as the extent of other auditor involvement increases.

### **WHAT CAN YOU DO TO PREPARE?**

As described above, although the significance will vary, the provisions are expected to impact all audits involving other auditors. Both lead auditors and other auditors can take actions now to prepare for implementation, including:

- + Both lead and other auditors can familiarize themselves with the provisions of the new and amended standards.
- + Lead auditors can communicate with audit committees and

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management about the new requirements and the related impacts to the audit.

- + Other auditors can communicate with component management about the new requirements and the related impacts to the audit.
- + Lead auditors can consider historical levels of involvement with other auditors and begin to assess how direction, supervision and review may need to be adjusted to comply with the new requirements. Lead auditors can communicate with other auditors regarding expected changes, including the nature and form of information that will need to be shared.
- + Other auditors can proactively engage in discussions with the lead auditor regarding expected changes to their direction, supervision and review, and incremental time and effort that may be expected as a result.

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## Resource links

- + [Planning and Supervision of Audits Involving Other Auditors and Dividing Responsibility for the Audit with Another Accounting Firm, PCAOB Release No. 2022-002 \(June 21, 2022\) \(“PCAOB Adopting Release”\)](#)
- + [PCAOB AS 2101: \*Audit Planning\* \(amended for FYE on or after 12/15/2024\)](#)
- + [PCAOB AS 1201: \*Supervision of the Audit Engagement\* \(amended for FYE on or after 12/15/2024\)](#)
- + [PCAOB AS 1206: \*Dividing Responsibility for the Audit with Another Accounting Firm\* \(new for FYE on or after December 15, 2024\)](#)
- + [PCAOB Staff Presentation on Audits Involving Other Auditors \(Part 1\) Video \(November 2023\)](#)
- + [PCAOB Staff Presentation on Audits Involving Other Auditors \(Part 2\) Video \(November 2023\)](#)