



**AUDITING STANDARDS BOARD
MEETING AGENDA
July 19-21, 2022
Washington, DC
(Times are EST)**

Tuesday, July 19	Wednesday, July 20	Thursday, July 21
<p>9:00–9:30 Agenda Item 1 Chair/AICPA Update</p> <p>9:30–10:30 Agenda Item 2 AU-C 935 Final Standard Vote to Issue</p> <p>10:30–11:00 <i>Break</i></p> <p>11:00–12:30 Agenda Item 3 Group Audits Comment Letters</p> <p>12:30–1:45 <i>Lunch</i></p> <p>1:45–2:45 Agenda Item 4 TIC Liaison Liaison Meeting</p> <p>Agenda Item 5 Executive Sessions Agenda Item 6</p>	<p>9:00–1:00 Agenda Item 7 10:30–11:00 <i>Break</i></p> <p>IAASB Projects</p> <ul style="list-style-type: none"> • Update • LCE Project • Sustainability • Fraud • Going Concern • PIE Update • Audit Evidence <p>1:00–2:00 <i>Lunch</i></p> <p>Agenda Item 8 Executive Sessions Agenda Item 9</p>	<p>9:00–10:10 Agenda Item 10 Technology TF and Blockchain Update and educate</p> <p>10:10–11:00 <i>Break</i></p> <p>11:00–12:00 Agenda Item 11 ASEC Liaison Liaison meeting</p> <p>12:00–12:15 Agenda Item 2 Debrief & Concluding Remarks</p>

AU-C 935 Amendments

I. Objective of Agenda Item

To review and vote to issue as final proposed Statement on Auditing Standards (SAS) *Amendments to AU-C Section 935*. The proposed SAS proposes amendments to AU-C section 935, *Compliance Audits*, to update AU-C section 935 *Appendix—AU-C Sections That Are Not Applicable to Compliance Audits* and to conform AU-C section 935 for the issuance of the following SASs:

- SAS No. 142, *Audit Evidence* (AU-C sec. 500)
- SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (AU-C sec. 315)

II. AU-C 935 Task Force

Maria Manasses, *Chair*
Maxene Bardwell
Erica Forhan
Mandy Nelson
George Strudgeon

The Task Force is staffed by Ahava Goldman and Teresa Bordeaux, *AICPA Governmental Auditing and Accounting Team*.

III. Background

AU-C section 935, *Compliance Audits*, addresses the application of GAAS to a compliance audit. AU-C sections 200–900 address audits of financial statements, as well as other kinds of engagements. Generally, these AU-C sections can be adapted to the objectives of a compliance audit. However, certain AU-C sections, or portions thereof, are not applicable to a compliance audit because (a) they are not relevant to a compliance audit environment, (b) the procedures and guidance would not contribute to meeting the objectives of a compliance audit, or (c) the subject matter is specifically covered in AU-C section 935. These AU-C sections, or specified requirements thereof, are identified in the appendix to AU-C section 935, “AU-C Sections That Are Not Applicable to Compliance Audits” (“the Appendix”).

The AU-C 935 Task Force was charged with proposing amendments to AU-C section 935, *Compliance Audits*, to update the Appendix and conform AU-C section 935 for the issuance of the following SASs:

- SAS No. 142, *Audit Evidence* (AU-C sec. 500)
- SAS No. 143, *Auditing Accounting Estimates and Related Disclosures*
- SAS No. 144, *Amendments to AU-C Sections 501, 540, and 620 Related to the Use of Specialists and the Use of Pricing Information Obtained From External Information Sources* (AU-C sec. 540)
- SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (AU-C sec. 315)

IV. Summary of Comments and Task Force Response

Fourteen (14) **comment letters** were received. All were supportive of the project and agreed with the proposed effective date. Informal comments were submitted in support of the amendments (that is, a few firms not wishing to go through the formal process of issuing letters indicated their support verbally to the Task Force chair).

Comments suggesting revisions to the proposed standards were primarily editorial. The Task Force discussed each comment (see rows 27-36 in agenda item 2B). The Task Force did not change any wording that was consistent with wording in another AU-C section. In addition, the Task Force concluded that certain comments were best addressed through the Governmental Audit & Accounting Guide, and the AICPA staff liaison to the Governmental Expert Panel took note of those. Lastly, certain comments will be addressed through the supplemental material issued with each new standard, such as *At a Glance* and the Executive Summary.

The Task Force is proposing the following revisions to the proposed standard:

A. **Effective Date**

One comment requested expansion and revision of the wording of the effective date.

As Exposed

1. This amendment is effective for compliance audits for fiscal periods ending on or after December 15, 2023, except as indicated in the appendix in renumbered paragraph .A45.

Proposed Revision

1. The amendment relating to AU-C section 501 in the Appendix, “AU-C Sections That Are Not Applicable to Compliance Audits”, is effective for compliance audits for fiscal periods ending on or after December 15, 2022. All other amendments are effective for compliance audits for fiscal periods ending on or after December 15, 2023.

B. **Paragraph .02 of AU-C 935**

Two comments suggested clarifications to paragraph 2 of AU-C section 935 with regard to the applicability of the standard, as follows:

- One respondent noted that most states and federal agencies perform numerous compliance audits every year that are not related to “...an audit of a complete set of financial statements...single financial statement or an audit of a specific element, account, or item of a financial statement.” Such compliance audits may be performed in accordance with GAAS.
- Another respondent noted that the proposed amendments to paragraph 2 of AU-C 935 include an edit to clarify that compliance audits can not only be performed in conjunction with a complete set of financial statements, but also in conjunction with an audit of a single financial statement or an audit of a specified element, account, or item of a financial statement. While the proposed SAS revised the first sentence of paragraph 2, it did not similarly revise the last sentence to replace “audit of financial statements” with the complete list of types of audits of historical financial information.

As exposed

- .02** This section addresses the application of GAAS to a compliance audit. Compliance audits usually are performed in conjunction with ~~a financial statement~~ **an audit of a complete set of financial**

statements, but may also be performed in conjunction with an audit of a single financial statement or an audit of a specific element, account, or item of a financial statement. This section does not apply to the financial statement audit component of such engagements. Although certain AU-C sections are not applicable to a compliance audit, as identified in the [appendix](#) “AU-C Sections That Are Not Applicable to Compliance Audits,” all AU-C sections other than this section are applicable to the audit of financial statements performed in conjunction with a compliance audit.

Proposed revision:

.02 This section addresses the application of GAAS to a compliance audit. Compliance audits ~~usually are~~ **may be** performed in conjunction with ~~a financial statement~~ **an audit of a complete set of financial statements, an audit of a single financial statement, or an audit of a specific element, account, or item of a financial statement.** This section does not apply to ~~the~~ **an audit of a complete set of financial statements, an audit of a single financial statement, or an audit of a specific element, account, or item of a financial statement, even when such audit is performed in conjunction with a compliance audit** component of such engagements. Although ~~certain~~ **Certain** AU-C sections are not applicable to a compliance audit, as identified in the [appendix](#) “AU-C Sections That Are Not Applicable to Compliance Audits.” ~~all AU-C sections other than this section are applicable to the audit of financial statements performed in conjunction with a compliance audit.~~

Agenda Items Presented:

- 2A** Summary of Comments
- 2B** Proposed SAS *Amendments to AU-C section 935*
- 2C** Executive Summary

AU- C 935 Summary of Comments

Respondents

1. Commonwealth of Virginia
2. Michigan Office of the Auditor General
3. Tennessee Comptroller of The Treasury
4. Virginia Society of CPAs
5. National State Auditors Association
6. RSM US LLP
7. KPMG LLP
8. Texas Society of Certified Public Accountants
9. Eide Bailly LLP
10. National Association of State Boards of Accountancy
11. Florida Institute of Certified Public Accountants
12. Association of Local Government Auditors
13. Deloitte & Touche LLP
14. Moss Adams LLP

Agenda Item 2A – AU-C 935 Amendments Summary of Comments

Row #	Node	Name	Coded Text	Comment
1	Q1\Agree	01-Virginia State Auditor	We agree with the Board's proposed changes to the existing standards.	Supportive
2	Q1\Agree	02-michigan	Yes, we consider the amendments as thorough and properly address the issues noted with SAS 142 and SAS 145. We have no suggested edits.	Supportive
3	Q1\Agree	03-Tennessee	We believe the proposed amendments to AU-C 935, including the proposed amendments to the appendix, are appropriate and complete. We also agree that the proposed changes are consistent with SASs 142 and 145.	Supportive
4	Q1\Agree	04-virginia-society	Overall, we support the proposed amendments to AU-C Section 935. We believe the proposed amendments are appropriate and complete. The additional language identifying paragraphs that are not applicable to a compliance audit is helpful to those in public practice and consistent with SAS 142 and 145.	Supportive
5	Q1\Agree	05-nsaa	We believe the proposed amendments to AU-C section 935, as well as to the appendix, are appropriate and complete.	Supportive
6	Q1\Agree	06-rsm-us-llp	We believe the proposed amendments to AU-C section 935 and its appendix are appropriate and complete.	Supportive
7	Q1\Agree	07-kpmg	Yes, we believe the Proposed SAS is complete and provides conformity to reflect the issuance of SAS No. 142, Audit Evidence (AU-C section 500) and SAS No. 145, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (AU-C section 315). Further, we believe the Proposed SAS is consistent with SAS Nos. 142 and 145.	Supportive
8	Q1\Agree	08-txcpa	The PSC has concluded that the proposed statement of amendment to AU-C Section 935 is consistent with SAS Nos. 142 and 145. Proposed changes to AU-C Section 935 appear to extend requirements currently in place for other audit types to compliance audits and are consistent with clarifications and examples provided in previous guidance. The proposed statement does not appear to contain changes from existing practice.	Supportive
9	Q1\Agree	09-eide bailey	We believe that the proposed amendments to AU-C 935 are appropriate.	Supportive

Agenda Item 2A – AU-C 935 Amendments Summary of Comments

Row #	Node	Name	Coded Text	Comment
10	Q1\Agree	10-nasba	The proposed amendments to AU-C section 935, including the proposed amendments to the appendix, are appropriate. We have reviewed the document and have no further comments.	Supportive
11	Q1\Agree	11-FICPAS	The Committee believes the proposed amendments will result in consistency of applying recently issued SASs in audits of financial statements and in compliance audits.	Supportive
12	Q1\Agree	12 -ALGA	We agree that the proposed amendments to AU-C Section 935 are appropriate.	Supportive
13	Q1\Agree	12 -ALGA	Lastly, we agree that the proposed revisions to AU-C Section 935, arising from changes to SAS Nos. 142 and 145, are consistent with the statements and help to ensure their continued applicability to the compliance audit.	Supportive
14	Q1\Agree	13-Deloitte	Yes, Deloitte believes that the proposed amendments to AU-C 935, including the updates to the appendix, are appropriate and complete. We believe that the conforming changes for SAS 142, Audit Evidence, and SAS 145, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement, were appropriately incorporated into the proposed amendments.	Supportive
15	Q1\Agree	14-Moss Adams	<p>We support the efforts of the Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants (AICPA) to conform AU-C section 935 to reflect recently issued standards, and clean up certain inconsistencies that existed. We anticipate many more compliance audits being performed in the future, and as new auditors come to apply AU-C section 935 for the first time, it's very helpful for the section to be well integrated into the rest of the codified auditing standards.</p> <p>We believe the proposed amendments to AU-C section 935 and related appendix are appropriate and complete, considering the objective to conform AU-C section 935 to reflect recently issued standards. We look forward to and support the further proposed amendment of AU-C section 935, included in the Exposure Draft Proposed Statement on Auditing Standards, <i>Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)</i>, that would indicate that AU-C section 600 is not applicable to compliance audits.</p>	Supportive
16	Q2\Agree	03-Tennessee	We agree that the proposed effective date is clear.	Supportive

Agenda Item 2A – AU-C 935 Amendments Summary of Comments

Row #	Node	Name	Coded Text	Comment
17	Q2\Agree	04-virginia-society	We also believe the effective date of the proposed amendments are clear.	Supportive
18	Q2\Agree	05-nsaa	We believe the effective date of the proposed amendments is clear.	Supportive
19	Q2\Agree	06-rsm-us-llp	We believe the effective date of the proposed amendments is clear. We believe the information provided in the “Explanation of Effective Date” section is very helpful in clarifying why the amendment to the appendix with regard to AU-C section 501 is effective earlier than all the other proposed amendments.	Supportive
20	Q2\Agree	07-kpmg	Yes, we believe the effective date is sufficiently described in the Proposed SAS and in the appendix in renumbered paragraph .A45.	Supportive
21	Q2\Agree	08-txcpa	The PSC thinks that the proposed effective date of the proposed amendments is clear.	Supportive
22	Q2\Agree	09-eide bailey	The effective dates, as written, are clear.	Supportive
23	Q2\Agree	10-nasba	The description of the effective date of the proposed amendments is clear. Because these types of compliance audits are completed in conjunction with a financial statement audit, it makes sense to align the effective dates of the proposed amendments to the underlying SASs.	Supportive
24	Q2\Agree	12 -ALGA	The effective date of the proposed amendments is clear.	Supportive
25	Q2\Agree	13-Deloitte	Yes, Deloitte believes that the effective dates in the proposed SAS are clear.	Supportive
26	Q2\Agree	14-Moss Adams	We also believe the stated rationale for the effective date is clear, and we appreciate the ability to early implement.	Supportive
27	Q2\Revise: Par. 1	02-michigan	The ED states “All other proposed amendments in this proposed SAS would be effective for compliance audits for fiscal periods ending on or after December 15, 2023. Early implementation is permitted.” Instead of the “early implementation is permitted” provision, consider amending that sentence to require adopting these amendments when SAS 145 is adopted. This will remind early adopters of SAS 145 to adopt the AU-C 935 amendments at the same time.	To be addressed in supporting documents (At a Glance)

Agenda Item 2A – AU-C 935 Amendments Summary of Comments

Row #	Node	Name	Coded Text	Comment
28	Q2\Revise Par. 1	11-FICPAS	<p>It is the opinion of the Committee that the effective date language in paragraph 1 of the ED needs to be expanded. The Effective Date section of the Explanatory Memorandum accompanying the ED uses different language to communicate the effective date of the proposed standard than the language in paragraph 1 in the body of the ED. Paragraph 1 of the ED delineates only the December 15, 2023, date and then references the renumbered paragraph .A45 in the appendix for exceptions to this effective date. The Explanatory Memorandum specifies the December 15, 2023, effective date with regard to AU-C section 501, <i>Audit Evidence – Specific Considerations for Selected Items</i>, and then states “All other proposed amendments in this proposed SAS would be effective for compliance audits for fiscal periods ending on or after December 15, 2023.”.</p> <p>The Committee believes the language in paragraph 1 of the ED should include language similar to the Explanatory Memorandum. Additionally, the Committee believes solely referencing a paragraph in a related appendix is inappropriate and may cause confusion among auditors.</p>	See issue A
29	Editorial: Par. 2	11-FICPAS	<p>However, the Committee has the following concerns.</p> <ul style="list-style-type: none"> · Paragraph .02 as amended is not necessarily true for compliance audits performed at the state and federal level. Most states and federal agencies perform numerous compliance audits every year that are not related to “...an audit of a complete set of financial statements...single financial statement or an audit of a specific element, account, or item of a financial statement.” These audits are typically performance audits or attest engagements (as defined in Government Auditing Standards) which require the auditors to perform these engagements in accordance with GAAS. Therefore, the Committee believes paragraph .02 should clarify the requirements of AU-C section 935 apply to these types of compliance audits. 	See Issue B. Note, performance audits are not performed in accordance with GAAS.

Row #	Node	Name	Coded Text	Comment
30	Editorial: Par. 02	13-Deloitte	<p>The proposed amendments to paragraph 2 of AU-C 935 include an edit to clarify that compliance audits can not only be performed in conjunction with a complete set of financial statements, but also in conjunction with an audit of a single financial statement or an audit of a specified element, account, or item of a financial statement. While the proposed SAS revised the first sentence of paragraph 2, it did not similarly revise the last sentence to replace “audit of financial statements” with the complete list of types of audits of historical financial information. However, instead of revising the last sentence to also include how AU-C section 805, <i>Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement</i>, applies, we recommend one of the following alternatives for clarity and simplicity (additions are shown in bold underline and deletions are shown in strikethrough text):</p> <p>.02 This section addresses the application of GAAS to a compliance audit. Compliance audits usually are performed in conjunction with <u>This section (including the appendix “AU-C Sections That Are Not Applicable to Compliance Audits”)</u> does not apply to the an audit of a complete set of financial statements, but may also be performed in conjunction with an audit of a single financial statement, or an audit of a specific element, account, or item of a financial statement, which are usually performed in conjunction with a compliance audit. This section does not apply to the financial statement audit component of such engagements. Although certain AU-C sections are not applicable to a compliance audit, as identified in the appendix “AU-C Sections That Are Not Applicable to Compliance Audits,” all AU-C sections other than this section are applicable to the audit of financial statements performed in conjunction with a compliance audit.</p> <p style="text-align: center;">OR</p> <p>.02 This section addresses the application of GAAS to a compliance audit. Compliance audits usually are performed in conjunction with an audit of a complete set of financial statements, but may also be performed in conjunction with an audit of a single financial statement, or an audit of a specific element, account, or item of a financial statement. This section (including the appendix “AU-C Sections That Are Not Applicable to Compliance Audits”) does not</p>	See Issue B

Agenda Item 2A – AU-C 935 Amendments Summary of Comments

Row #	Node	Name	Coded Text	Comment
			<p>apply to the audit of a complete set of financial statements, audit component of such engagements. audit of a single financial statement, or audit of a specific element, account, or item of a financial statement, which are usually performed in conjunction with a compliance audit. Although certain AU-C sections are not applicable to a compliance audit, as identified in the appendix “AU-C Sections That Are Not Applicable to Compliance Audits,” all AU-C sections other than this section are applicable to the audit of financial statements performed in conjunction with a compliance audit.</p>	
31	Editorial: Par. 19	12 -ALGA	<p>However, the AICPA should consider revising Paragraph .19 of the Requirements section, Assessing Inherent Risk, for added clarity. The phrase “take into account” does not appear applicable to assessing the inherent risk for noncompliance. Assessing the likelihood and magnitude of noncompliance involves determining how and to what degree inherent risk factors affect how susceptible compliance requirements are to noncompliance. As such, we propose the following change to this paragraph:</p> <p>Assessing Inherent Risk .19 For identified risks of material noncompliance for each applicable compliance requirement, the auditor should assess inherent risk by assessing the likelihood and magnitude of noncompliance. In doing so, the auditor determines how, and the degree to which, inherent risk factors affect the susceptibility of compliance requirements to noncompliance.</p>	<p>Phrase “taking into account” is consistent with AU-C section 315, and using “determine” would change the auditor’s responsibilities; no change.</p>
32	Editorial: Par. A14	11-FICPAS	<p>Paragraph .A14 in the Application and Other Explanatory Material section delineates five interrelated components of internal control for purposes of Generally Accepted Auditing Standards (GAAS). It is the opinion of the Committee that these elements should be listed in the same order as the elements delineated in the Committee of Sponsoring Organizations (COSO) Framework. Since the Uniform Guidance issued by the Office of Management and Budget cites the COSO Framework as a best practice (i.e., “should”), the Committee believes the elements in audit standards relating to compliance audits should follow the order of the COSO Framework.</p>	<p>Listed in same order as in AU-C section 315; no change</p>

Agenda Item 2A – AU-C 935 Amendments Summary of Comments

Row #	Node	Name	Coded Text	Comment
33	Editorial: Par. A15	06-RSM	<p>We ask that the board consider whether new paragraph .A15 of the proposed SAS would be easier to understand if it were revised to consistently refer to “controls” in the plural form of the word as follows (proposed deletions are struck through, and proposed additions are underlined):</p> <p style="padding-left: 40px;">A15 Evaluating whether controls that address risks of material noncompliance are effectively designed, and determining whether those controls have been implemented, involves considering whether the identified controls, individually or in combination, are capable of effectively preventing, or detecting and correcting, material noncompliance as well as establishing that the controls <u>over compliance</u> exist, and that the entity is using <u>them</u>.</p>	No change, wording is consistent with AU-C section 315.
34	Editorial: Appendix	09-Eide Bailey	<p>However, we believe additional clarification in the appendix would help auditors to understand the applicability, or lack thereof, of certain other AU-C sections to AU-C 935 engagements. Because the auditing standards are written from a financial statement perspective, there can be confusion regarding which sections are also applicable in a compliance audit. This lack of clarity can create diversity in practice in applying the relevant auditing standards to compliance audits. While not a fully inclusive list, below are some examples where clarity would be helpful. Within the appendix of this ED and on a more limited scale in the extant AU-C 935, the identification of significant risks as outlined in paragraphs .32-.38 of AU-C Section 315, <i>Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement</i> is not applicable to a compliance audit; however, AU-C Section 260, <i>The Auditor’s Communication with Those Charged with Governance</i> (AU-C 260) is fully applicable. How does paragraph 11 of AU-C 260, which requires communication of significant risks identified by the auditor to those charged with governance, apply to a compliance audit when the identification of significant risks within AU-C 315 has been scoped out by the appendix and risk assessment within AU-C 935 does not incorporate a process to identify significant risks? Is it the Board’s intent for auditors to communicate identified risks of noncompliance to those charged with governance as significant risks, even though the concept of a significant risk is not applicable?</p>	Because the requirement to identify significant risks is scoped out, no significant risks would be identified; therefore, the requirement to communicate identified significant risks is not applicable in the circumstances. Noted for clarification in future editions of the Governmental AAG.

Agenda Item 2A – AU-C 935 Amendments Summary of Comments

Row #	Node	Name	Coded Text	Comment
35	Editorial: Appendix	09-Eide Bailey	Another item for consideration is related to AU-C Section 240, <i>Consideration of Fraud in a Financial Statement Audit</i> (AU-C 240) specifically paragraph .29c, which states that the auditor should “incorporate an element of unpredictability in the selection of nature, timing, and extent of audit procedures” in determining overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level. Paragraph .29c is not scoped out in the appendix to AU-C 935; however, given the nature of compliance audits and their objective to provide an opinion on compliance with applicable compliance requirements, it is unclear whether an element of unpredictability is also required in a compliance audit performed in accordance with AU-C 935. We recognize this is not a change from the extant AU-C 935 appendix; however, we thought it would be helpful for the Board to provide clarification about whether it is their intent for auditors to incorporate an element of unpredictability in a compliance audit.	Noted for clarification in future editions of the Governmental AAG.
36	Editorial: other	03-Tennessee	We do, however, suggest that the ASB consider adding the reasons (i.e., why) for the changes from the “Explanatory Memorandum” to the “Application and Other Explanatory Material” similar to a “Basis for Conclusions” in GAAP. This would provide more context for auditors to apply their professional judgment.	To be addressed in supporting documents (Executive Summary)



**Statement on
Auditing Standards**
Issued by the Auditing Standards Board

MONTH 2022
14X

AMENDMENT TO AU-C SECTION 935

(Amends Statement on Auditing Standards [SAS] No. 117, Compliance Audits, as amended [AICPA, Professional Standards, AU-C sec. 935])

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Note: Statements on Auditing Standards are issued by the Auditing Standards Board, the senior technical body of the AICPA designated to issue pronouncements on auditing matters. The “Compliance With Standards Rule” (ET sec. 1.310.001)¹ of the AICPA Code of Professional Conduct requires compliance with these standards in an audit of a nonissuer.

¹ All ET sections can be found in [AICPA Professional Standards](#).

PROPOSED STATEMENT ON AUDITING STANDARDS

AMENDMENT TO AU-C SECTION 935

(*Boldface italics* denotes new language. Deleted text is shown in ~~strikethrough~~.)

Amendment to AU-C Section 935, *Compliance Audits*

1. ~~The amendment relating to AU-C section 501 in the Appendix – AU-C Sections That Are Not Applicable to Compliance Audits is effective for compliance audits for fiscal periods ending on or after December 15, 2022. All other amendments are effective for compliance audits for fiscal periods ending on or after December 15, 2023, except as indicated in the appendix in renumbered paragraph .A45.~~

[No amendment to paragraph .01.]

.02 This section addresses the application of GAAS to a compliance audit. Compliance audits ~~usually are~~ *may be* performed in conjunction with ~~a financial statement~~ *an audit of a complete set of financial statements, but may also be performed in conjunction with an audit of a single financial statement, or an audit of a specific element, account, or item of a financial statement.* This section does not apply to ~~the financial statement~~ *an audit of a complete set of financial statements, an audit of a single financial statement, or an audit of a specific element, account, or item of a financial statement, even when such audit is performed in conjunction with a compliance audit* ~~component of such engagements. Although certain~~ *Certain* AU-C sections are not applicable to a compliance audit, as identified in the appendix “AU-C Sections That Are Not Applicable to Compliance Audits.” ~~all AU-C sections other than this section are applicable to the audit of financial statements performed in conjunction with a compliance audit.~~

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[No amendment to paragraph .03–.11.]

Requirements

Adapting and Applying the AU-C Sections to a Compliance Audit (Ref: [par. .A5](#) and [.A40A2](#))

.12 When performing a compliance audit, the auditor, ~~using~~ *exercising* professional judgment, should adapt and apply the AU-C sections to the objectives of a compliance audit, except for the AU-C sections listed in the [appendix](#).

[No amendment to paragraphs .13–.14.]

Performing Risk Assessment Procedures (Ref: [par. .A12–.A15/7](#))

.15 For each of the government programs and applicable compliance requirements selected for testing, the auditor should perform risk assessment procedures to obtain a sufficient understanding of the applicable compliance requirements and the entity’s internal control over compliance with the applicable compliance requirements.^{fn 1}

^{fn 1} Paragraphs ~~.03–.12b~~ and ~~.12d–.25.11–.19a, .19c, .21–.26, and .27b–.31~~ of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

.16 *In adapting and applying the requirements of section 315 to identify controls that address risks of material noncompliance,^{fn2} the auditor should perform risk assessment procedures, beyond inquiry, to evaluate whether the following controls that address risks of material noncompliance are effectively designed and determine whether those controls have been implemented:*

- a. Controls over journal entries and other adjustments as required by section 240, Consideration of Fraud in a Financial Statement Audit*
- b. Controls for which the auditor plans to test operating effectiveness in determining the nature, timing, and extent of substantive procedures, which include
 - i. controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence, and*
 - ii. controls that are required to be tested for operating effectiveness by the governmental audit requirement as required by paragraph 24 of this section**
- c. Other controls that, based on the auditor’s professional judgment, the auditor considers are appropriate to enable the auditor to identify and assess risks of material noncompliance and design further audit procedures.*

^{fn2} Paragraphs ~~.27b–d~~ and ~~.30~~ of section 315.

[Subsequent footnotes are renumbered. No amendment to paragraph .16, which is renumbered as paragraph .17.]

Identifying and Assessing the Risks of Material Noncompliance (Ref: [par. .A16 A17–.A18A19](#))

.17/8 The auditor should identify ~~and assess~~ the risks of material noncompliance whether due to fraud or error for each applicable compliance requirement and should consider whether any of those risks are pervasive to the entity’s compliance because they may affect the entity’s compliance with many compliance requirements.

Assessing Inherent Risk

.19 For identified risks of material noncompliance for each applicable compliance requirement, the auditor should assess inherent risk by assessing the likelihood and magnitude of noncompliance. In doing so, the auditor should take into account how, and the degree to which, inherent risk factors affect the susceptibility of compliance requirements to noncompliance.

.20 The auditor should determine whether substantive procedures alone cannot provide sufficient appropriate audit evidence for any of the risks of material noncompliance.

Assessing Control Risk

.21 For identified risks of material noncompliance for each applicable compliance requirement, the auditor should assess control risk based on the auditor's understanding of controls and the auditor's plan to test the operating effectiveness of controls. If the auditor does not plan to test the operating effectiveness of controls, the auditor should assess control risk at the maximum level such that the assessment of the risk of material noncompliance is the same as the assessment of inherent risk.

Performing Further Audit Procedures in Response to Assessed Risks

[No amendment to former paragraphs .18–.19, which are renumbered as paragraphs .22–.23.]

~~.20~~²⁴ The auditor should design and perform further audit procedures in response to the assessed risks of material noncompliance. These procedures should include performing tests of controls over compliance if

a. [▲] the auditor's risk assessment includes an expectation of the operating effectiveness of controls over compliance related to the applicable compliance requirements;

b. [▲] substantive procedures alone ~~do not~~^{cannot} provide sufficient appropriate audit evidence; or

c. [▲] such tests of controls over compliance are required by the governmental audit requirement.

If any of the conditions in this paragraph are met, the auditor should test the operating effectiveness of controls over each applicable compliance requirement to which the conditions apply in each compliance audit. (Ref: [par. .A2426–.A2527](#))

[No amendment to former paragraphs .21–.39, which are renumbered as paragraphs .25–.43.]

Documentation (Ref: [par. .A4042](#))

~~.40~~⁴⁴ The auditor should document

a. the risk assessment procedures performed, including those related to ~~gaining~~^{obtaining} an understanding of internal control over compliance, *and* ^{in 4213}

- b. *the identified and assessed risks of material noncompliance, including risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence, and the rationale for the significant judgments made.*

^{fn 413} Paragraph ~~33a-b~~ and ~~33d.42a-c~~ of section 315A.

[No amendment to former paragraphs .41–.44, which are renumbered as paragraphs .45–.48.]

Application and Other Explanatory Material

[No amendment to paragraphs .A1–.A11.]

Performing Risk Assessment Procedures (Ref: [par. .15–.16/7](#))

- .A12** Obtaining an understanding of the government program, the applicable compliance requirements, and the entity’s internal control over compliance establishes a frame of reference within which the auditor plans the compliance audit and exercises professional judgment about *identifying and* assessing risks of material noncompliance and responding to those risks throughout the compliance audit. *The auditor is also responsible for evaluating the audit evidence obtained from the risk assessment procedures and, as applicable, revising the identification or assessment of risks of material noncompliance.* ^{fn15}

^{fn15} Paragraphs .39 and .41 of section 315.

[Subsequent footnotes are renumbered. No amendment to paragraph .A13.]

- .A14** ~~Performing risk assessment procedures to obtain an understanding of the entity’s internal control over compliance includes an evaluation of the design of controls and whether the controls have been implemented. For purposes of GAAS, the system of internal control~~ consists of the following five interrelated components: ~~the control environment, the entity’s risk assessment process, information and communication systems, control activities, and the entity’s process to monitoring the system of internal control, the information system and communication, and control activities.~~ Section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, contains a detailed discussion of these components. ^{fn 4517}

^{fn 4517} Paragraphs ~~15–25.21–.26, .27b–.31,~~ and appendix CB, “*Understanding the Entity’s System of Internal Control Components*,” of section 315A.

- .A15** *Evaluating whether controls that address risks of material noncompliance are effectively designed, and determining whether those controls have been implemented involves considering whether the identified controls, individually or in combination, are capable of effectively preventing, or detecting and correcting, material noncompliance as well as establishing that the control exists, and that the entity is using it.* ^{fn18}

^{fn 18} Paragraph .A105 of section 315.

.A16 Section 315 includes additional requirements related to control activities related to risks arising from the use of IT that also apply to a compliance audit.^{fn19}

^{fn 19} Paragraphs .28–.29 of section 315.

[Subsequent footnotes are renumbered. No amendment to former paragraph .A15, which is renumbered as paragraph .A17.]

Identifying and Assessing the Risks of Material Noncompliance (Ref: [par. .47/8](#))

~~.A16~~**18***Inherent risk* Factors the auditor may consider *and other considerations* in identifying and assessing the risks of material noncompliance are as follows *may include the following*:

- *Criteria for identifying and assessing risks of material noncompliance identified by the governmental audit requirement as well as related communications from oversight organizations or regulators*
- The complexity of the applicable compliance requirements
- The susceptibility of the applicable compliance requirements to noncompliance
- The length of time the entity has been subject to the applicable compliance requirements
- The auditor’s observations about how the entity has complied with the applicable compliance requirements in prior years
- The potential effect on the entity of noncompliance with the applicable compliance requirements
- The degree of judgment involved in adhering to the compliance requirements
- The auditor’s assessment of the risks of material misstatement in the financial statement audit

~~.A17~~**19***The auditor may find it helpful to consider the relevant application material in section 315, adapted as necessary for a compliance audit, when* ~~in~~ identifying and assessing the risks of material noncompliance, ~~the auditor may evaluate inherent risk of noncompliance and control risk of noncompliance individually or in combination.~~^{fn 20}

^{fn 20} Paragraphs .A235, .A237–.A244, and .A252–.A263 of section 315.

[Subsequent footnotes are renumbered. No amendment to former paragraphs .A18–.A22, which are renumbered as paragraphs .A20–.A24.]

Performing Further Audit Procedures in Response to Assessed Risks

...

~~.A23~~25 The use of *substantive* analytical procedures to ~~gather substantive~~*obtain* evidence *in responding to assessed risks of material noncompliance* is generally less effective in a compliance audit than it is in a financial statement audit. However, substantive analytical procedures may contribute some evidence when performed in addition to tests of transactions and other auditing procedures necessary to provide the auditor with sufficient appropriate audit evidence. (Ref: [par. .1923](#))

[No amendment to former paragraphs .A24–.A42, which are renumbered as paragraphs .A26–.A44.]

Appendix — AU-C Sections That Are Not Applicable to Compliance Audits

~~.A43~~45 The following AU-C sections and individually enumerated requirement paragraphs of specific AU-C sections are not applicable to a compliance audit performed under this section either because (a) they are not relevant to a compliance audit environment, (b) the procedures and guidance would not contribute to meeting the objectives of a compliance audit, or (c) the subject matter is specifically covered in this section. Where the table in this appendix specifies individual requirement paragraphs rather than an entire AU-C section, the application and other explanatory material paragraphs related to such requirement paragraphs also do not apply. However, an auditor may apply these AU-C sections and paragraphs if the auditor believes doing so will provide appropriate audit evidence in the specific circumstances to support the auditor’s opinion on compliance.

<i>AU-C Section</i>	<i>Paragraphs Not Applicable to Compliance Audits</i>
210, <i>Terms of Engagement</i>	Paragraphs .06a and .08a
240, <i>Consideration of Fraud in a Financial Statement Audit</i>	Paragraphs .26 and .32b
250, <i>Consideration of Laws and Regulations in an Audit of Financial Statements</i>	All
315A, <i>Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement</i>	Paragraphs .19b, .20, .27a, .32–.38, .40, and .42d–.42e, .26–.30, and .33e
330, <i>Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained</i>	Paragraphs .13–.1415, .1819–.2122 , .26, and .31–.32
501, <i>Audit Evidence — Specific Considerations for Selected Items</i>	All <i>except paragraph .27*</i>
505, <i>External Confirmations</i>	All
510, <i>Opening Balances — Initial Audit Engagements, Including Reaudit Engagements</i>	Paragraphs .06, .08–.13, and .15–.17
540A, <i>Auditing Accounting Estimates and Related Disclosures</i>	All
550, <i>Related Parties</i>	All
560, <i>Subsequent Events and Subsequently Discovered Facts</i>	Paragraphs .09–.11 and .19–.20
570, <i>The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern</i>	All

<i>AU-C Section</i>	<i>Paragraphs Not Applicable to Compliance Audits</i>
600, <i>Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)</i>	Paragraphs .26, .39, .41c, .41d, .55, and .56c
700, <i>Forming an Opinion and Reporting on Financial Statements</i>	Paragraphs .13–.17, .21–.44, and .45–.61
701, <i>Communicating Key Audit Matters in the Independent Auditor’s Report</i>	All
703, <i>Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA</i>	All
705, <i>Modifications to the Opinion in the Independent Auditor’s Report</i>	Paragraphs .18–.20
706, <i>Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor’s Report</i>	Paragraphs .06–.07
708, <i>Consistency of Financial Statements</i>	All
720B, <i>Other Information Included in Annual Reports</i>	All
725, <i>Supplementary Information in Relation to the Financial Statements as a Whole</i>	All
730, <i>Required Supplementary Information</i>	All
800, <i>Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks</i>	All
805, <i>Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement</i>	All
806, <i>Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements</i>	All
810, <i>Engagements to Report on Summary Financial Statements</i>	All
910 , <i>Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country</i>	All
915 , <i>Reports on Application of Requirements of an Applicable Financial Reporting Framework</i>	All
920 , <i>Letters for Underwriters and Certain Other Requesting Parties</i>	All
925 , <i>Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933</i>	All
930 , <i>Interim Financial Information</i>	All
940 , <i>An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements</i>	All
945 , <i>Auditor Involvement With Exempt Offering Documents</i>	All
<p>[*] SAS No. 142, <i>Audit Evidence</i>, amended section 501, <i>Audit Evidence — Specific Considerations for Selected Items, to add paragraph .27 to section 501. That amendment is effective for audits of financial statements for periods ending on or after December 15, 2022. Consequently, the proposed amendment relating to AU-C section 501 in this appendix would become effective for compliance audits for fiscal periods ending on or after December 15, 2022, to align with the effective date of SAS No. 142. All other proposed revisions to this appendix would become effective for compliance audits for fiscal periods ending on or after December 15, 2023.</i></p>	

Exhibit — Illustrative Combined Report on Compliance With Applicable Requirements and Internal Control Over Compliance — (*Unmodified Opinion on Compliance, No Material Weaknesses or Significant Deficiencies in Internal Control Over Compliance Identified*)

.A4446

[The amendment is contained in the second paragraph of the “Report on Internal Control Over Compliance” section of the illustrative independent auditor’s report.]

...

Independent Auditor’s Report

...

Report on Internal Control Over Compliance

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance on a timely basis. A *material weakness* in internal control over compliance is a deficiency, or combination of deficiencies in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a compliance requirement will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the section above and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies in internal control over compliance. Given these limitations, during our audit we did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, material weaknesses or significant deficiencies in internal control over compliance may exist that ~~have were not been~~ identified.

Our audit was not designed for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, no such opinion is expressed.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing

based on the *[insert the name of the governmental audit requirement or program-specific audit guide]*. Accordingly, this report is not suitable for any other purpose.

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

Executive Summary

Statement on Auditing Standards (SAS) No. 148, *Amendment to AU-C Section 935*, amends SAS No. 117, *Compliance Audits*, as amended (AICPA, *Professional Standards*, AU-C sec. 935).

Background

AU-C section 935, *Compliance Audits*,¹ addresses the application of generally accepted auditing standards (GAAS) to a compliance audit. AU-C sections 200–900 address audits of financial statements as well as other kinds of engagements. Generally, these AU-C sections can be adapted to the objectives of a compliance audit. However, certain AU-C sections, or portions thereof, are not applicable to a compliance audit because (a) they are not relevant to a compliance audit environment, (b) the procedures and guidance would not contribute to meeting the objectives of a compliance audit, or (c) the subject matter is specifically covered in AU-C section 935. These AU-C sections, or specified requirements thereof, are identified in the appendix to AU-C section 935, “AU-C Sections That Are Not Applicable to Compliance Audits” (the appendix).

SAS No. 148 amends AU-C section 935 to update the appendix and conform AU-C section 935 to reflect the issuance of the following SASs:

- SAS No. 142, *Audit Evidence* (AU-C section 500)
- SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (AU-C section 315)

The Auditing Standards Board (ASB) has determined that no amendment is necessary to AU-C section 935 to reflect the issuance of the following SASs:

- SAS No. 143, *Auditing Accounting Estimates and Related Disclosures* (AU-C section 540)
- SAS No. 144, *Amendments to AU-C Sections 501, 540, and 620 Related to the Use of Specialists and the Use of Pricing Information Obtained From External Information Sources*

SAS No. 143 is codified in AU-C section 540, which is listed in the appendix as not applicable in its entirety to a compliance audit. SAS No. 144 amends only certain application material that is not relevant to AU-C section 935.

Explanation of Changes

Revisions Arising From SAS No. 142

SAS No. 142 superseded SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification*, section 500, *Audit Evidence* (AU-C sec. 500A), and amended various AU-C sections, including AU-C section 501, *Audit Evidence — Specific Considerations for Selected Items*. The amendments in SAS No. 142 moved what had been paragraph .08 of AU-C section 500A, relating to using the work of a management’s specialist, to become paragraph .27 of AU-C section 501, without any substantive changes to that paragraph. This paragraph was applicable to compliance audits when it was in AU-C section 500A, and that applicability didn’t change when it was relocated. Accordingly, the appendix is revised to reflect the continued applicability of this paragraph in a compliance audit. No other paragraph in AU-C section 501 applies to a compliance audit.

Revisions Arising From SAS No. 145

¹ All AU-C sections can be found in AICPA *Professional Standards*.

- Paragraphs .12c, .26–.30, and .33c of AU-C section 315A are not applicable to a compliance audit. The appendix was updated to include comparable paragraphs (19b, 20, 32–34, 36, and 42d) of SAS No. 145 as not applicable to a compliance audit.
- Paragraphs 27a of SAS No. 145, which relates to controls over significant risks, and paragraph 40, which relates to classes of transactions, account balances, and disclosures that are not significant but are material, were added to the appendix as not applicable in a compliance audit. Historically, the concept of significant risks has not been applicable to a compliance audit. Likewise, the concept of classes of transactions, account balances, and disclosures that are material is not applicable to a compliance audit.
- Paragraphs 26 and 27b–.30 of SAS No. 145, which address requirements related to the control activities component, apply to a compliance audit. In particular, paragraph 27b–d addresses certain controls that the auditor is required to identify. A new requirement was added to AU-C section 935 to address the auditor’s responsibility in adapting and applying paragraphs 27b–.30 of SAS No. 145 in a compliance audit. This new requirement also includes controls over compliance that are required to be tested for operating effectiveness by a governmental audit requirement (paragraph .20 of extant AU-C section 935). Thus, the new requirement combines the auditor’s responsibilities under AU-C section 315 and AU-C section 935. Paragraphs .28–.29 of AU-C section 315 include additional requirements related to control activities related to risks arising from the use of IT that also apply to a compliance audit.
- For ease of use and clarity of the requirements related to identifying and assessing risks of material noncompliance, paragraphs 35 and 37–38 of SAS No. 145, adapted as necessary, were added as requirements directly in AU-C section 935 and, consequentially, included in the appendix as not applicable when applying AU-C section 315 to a compliance audit. Application material was added to AU-C section 935 that references the 22 relevant application material paragraphs for paragraphs 35 and 37–38 in SAS No. 145.
- Extant AU-C section 935 excludes, within the appendix, the documentation requirement related to the identified and assessed risks at the financial statement level and assertion level (paragraph .33c of AU-C section 315A). The ASB believes that this requirement, adapted as necessary, is applicable to a compliance audit and, therefore, a new requirement was added to AU-C section 935 based on paragraph 42d of SAS No. 145, which, consistent with other revisions, excludes significant risks. Accordingly, paragraph 42d of SAS No. 145 has been included in the appendix (and thereby is not applicable in a compliance audit).

Other Revisions

- There is an inconsistency in extant AU-C section 935 whereby the requirements in AU-C section 315 with respect to significant risks were scoped out of a compliance audit, but the requirements in AU-C section 330 with respect to significant risks were not. This inconsistency has been removed by adding paragraphs .15 and .22 of AU-C section 330 to the appendix.
- Paragraph .18 of AU-C section 330 was also added to the appendix, as performing substantive procedures for each relevant assertion of each significant class of transactions, account balance, and disclosure is not applicable in a compliance audit.
- Certain other editorial revisions were made for clarity or consistency with other AU-C sections.

Effective Date

The amendment relating to AU-C section 501 in the Appendix, “AU-C Sections That Are Not Applicable to Compliance Audits”, is effective for compliance audits for fiscal periods ending on or after December 15, 2022, consistent with the effective date of SAS 142. All other amendments are effective for compliance audits for fiscal periods ending on or after December 15, 2023, consistent with the effective date of SAS 145.

The effective date of the amendment to the appendix with regard to AU-C section 501 is aligned with the effective date of SAS No. 142, because, as explained previously, this amendment arises from SAS No. 142. This amendment is not intended to change current practice, as there were no changes to the underlying requirement; only its placement within GAAS changed. All other amendments in SAS No. 148 arise from SAS No. 145 and, accordingly, their effective date is aligned with the effective date of SAS No. 145.

Early implementation of SAS No. 148 is permitted. The Auditing Standards Board recommends that any firm that performs compliance audits implement SAS No. 148 concurrently with its implementation of SAS No. 145.

Group Audits: Discussion Memorandum and Issues

Discussion of Comment Letter Responses to “Requests for Comment” in the Exposure Draft of the Proposed SAS *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*

I. Objectives of Agenda Item 3

To provide the Auditing Standards Board (ASB) with preliminary feedback from the comment letters received on the March 23, 2022, exposure draft of Proposed Statement on Auditing Standards (SAS) *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)* and to obtain direction from the ASB on certain matters.

II. Group Audits Task Force

The following are the members of the Group Audits Task Force:

- Dora Burzenski, Chair; assisted by Lauren Kolarik
- Mike Bingham
- Monique Booker
- Harry Cohen
- Heather Funsch
- Clay Huffman
- Maria Manasses
- Staffed by Judith Sherinsky

III. Background

The proposed SAS addresses audits of group financial statements and, if issued as a final SAS, would supersede extant AU-C section 600 *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*. It is intended to strengthen the auditor’s approach to planning and performing a group audit and to clarify the interaction of the proposed SAS with the other AU-C sections, including AU-C section 220, *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, and AU-C section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence*. In developing and updating its standards, one of the strategic objectives of the ASB is to converge its standards with those of the International Auditing and Assurance Standards Board (IAASB), while taking into consideration the standards of other standard setters, such as the Public Company Accounting Oversight Board (PCAOB) and the U.S. Government Accountability Office (GAO). The proposed SAS is based on International Standard on Auditing (ISA) 600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, which was approved at the December 2021 IAASB meeting and issued in April 2022.

IV. Agenda Materials

Agenda Item 3	Group Audits: Discussion Memorandum and Issues
Agenda Item 3A	Summary of Comments on Proposed SAS <i>Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-To Auditors)</i>

Agenda Item 3 – Group Audits: Discussion Memorandum and Issues

- Agenda Item 3B The March 23, 2022, exposure draft Proposed Statement on Auditing Standards (SAS) *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*
- Agenda Item 3C PCAOB AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*, per PCAOB Adopting Release No. 2022-002 dated June 21, 2022
- Agenda Item 3D Appendix B, *Audit Evidence Regarding Valuation of Investments Based on Investee Financial Results*, of PCAOB AS 1105, *Audit Evidence*, per PCAOB Adopting Release No. 2022-002 dated June 21, 2022
- Agenda Item 3E AU-C 501, *Audit Evidence — Specific Considerations for Selected Items*

Ms. Burzenski will use agenda item 3 for discussion purposes. In addition, Ms. Burzenski will provide a verbal summary to the board on the recently adopted PCAOB standards related to other auditors.

High Level Summary of Comment Letter Feedback

The ASB received 22 comment letters on the exposure draft (ED) of the proposed SAS, which seeks specific feedback from respondents on 13 different topics identified in the ED under the headings “Request for Comment.”

Overall, the responses to the ED were supportive of moving forward with convergence with ISA 600 (Revised), subject to further revisions to the ED to address comments received. Of note is that a number of respondents believe that certain aspects of the proposed SAS should be aligned with [PCAOB Release No. 2022-002](#).

Issues for ASB Consideration

The Group Audits Task Force (Task Force) is seeking direction from the ASB on the following four issues:

- [Issue 1:](#) Auditing components that are equity method investments (EMIs) and consideration of alignment with PCAOB standards.
- [Issue 2:](#) Structure of proposed standard related to referred-to auditors and consideration of alignment with PCAOB standards.
- [Issue 3:](#) Considering the magnitude of the portion of the financial statements audited by referred-to-auditors in determining whether sufficient appropriate audit evidence can reasonably be expected to be obtained (par. A41 of the ED).
- [Issue 4:](#) Recommendation for PEEC to align with the IESBA project and to clarify independence requirements for group audits.

The four issues above are discussed in this memo. All of the detailed responses to the requests for comment in the ED are contained in Agenda Item 3A.

The Task Force will more fully consider the comments received on the ED and bring an analysis of comments and recommendations to the ASB for consideration at the October 2022 ASB meeting.

Issue 1: Auditing Components That are Equity Method Investments (EMIs) and Consideration of Alignment with PCAOB Standards

Request for Comment 9: Components That Are Equity Method Investments

Question 9. Do you agree with the application material in paragraphs A47–A49 of the proposed SAS relating to a noncontrolling interest in an entity that is accounted for by the equity method? Are there additional requirements or application material relating to EMIs that are needed in the proposed SAS, and if so, what should they be?

Question 9: Do you agree with the application material in paragraphs A47–A49 of the proposed SAS relating to a noncontrolling interest in an entity that is accounted for by the equity method?	No. of Responses
Yes	12
No	6
No comment	4
No. of comment letters	22

Question 9: Are there additional requirements or application material relating to EMIs that are needed in the proposed SAS, and if so, what should they be?	No. of Responses
Additions needed	9
OK as is	6
No comment	7
No. of comment letters	22

Summary of Commenter Responses

(Note that the summary of responses have been reworded for brevity; see Item 3A for complete wording.)

Four commenters (E&Y, GT, PWC, and KPMG) commented on the alignment of the proposed SAS with PCAOB standards. In particular, they note the audit evidence that can be obtained from audited financial statements as well as the challenges encountered by group auditors in establishing an arrangement with the auditor of an EMI under which the group auditor would direct and supervise the activities of the auditor of the EMI and review that auditor’s work. These commenters generally recommended that the ASB align the proposed SAS with Appendix B, “Audit Evidence Regarding Valuation of Investments Based on Investee Financial Results,” of AS 1105, *Audit Evidence*, as amended in [PCAOB Release No. 2022-002](#) so that:

- If the audited financial statements of the EMI (including the accompanying auditor’s report) are determined to constitute sufficient appropriate audit evidence, the auditor of the EMI would not be considered a component auditor (i.e., not part of the engagement team), and therefore, the group auditor would not be required to direct and supervise the auditor of the EMI or review that auditor’s work.
- If the financial statements of the EMI are audited, the group auditor would be required to read the financial statements of the EMI and the accompanying auditor’s report, perform limited procedures to determine whether the report is satisfactory for the group auditor’s purpose, and if it is satisfactory, may be able to conclude that the financial statements and the auditor’s report constitute sufficient appropriate audit evidence. These procedures are similar to those related to investments in securities when valuations are based on the investee’s financial results in extant AU-C section 501, *Audit Evidence – Specific Considerations for Selected Items*.

- If in the auditor’s professional judgment additional audit evidence is needed, the group auditor would be required to perform procedures to gather such evidence.

Additionally:

- Three commenters requested that the ASB consider adding guidance that addresses situations in which no assurance exists relative to the EMI’s financial statements (i.e., the EMIs did not obtain separate audits). (NSAA, MI OAG, COV) One commenter would like to see additional guidance, such as a materiality threshold, on whether a failure to obtain information would be considered a scope limitation, also noting that reverting to the cost basis is not appropriate. (TXCPA)
- One commenter indicates that a group auditor should only be following the guidance in paragraph A48 of the proposed SAS if the group financial statements include a noncontrolling interest in an entity that is accounted for by the equity method investment (which reflects a risk of material misstatement to the group financial statements) and the group auditor’s access to information or people at the entity is restricted. The commenter is concerned that a group auditor may interpret the paragraph to mean that, even if they do not have specific access restrictions at the entity, they can directly apply A48 and obtain audited financial statements for the equity method investment and “take credit” for the substantive audit work performed on the equity method investment, without any interactions with the auditor of the equity method investment. To contribute to more consistent performance by group auditors, the commenter recommends that examples be provided to illustrate how differences in the risk assessment may impact the procedures performed by the group auditor. (Crowe)
- Two commenters believe paragraph A49 of the proposed SAS should be removed or updated because it suggests that restrictions on access to information or people of the equity method investee is an indicator that challenges management’s assertion with regard to accounting for the investment under the equity method (management’s assertion about the extent of influence it has on the EMI). Current accounting guidance regarding EMIs does not address restricted access in determining the extent of influence. The paragraph may be read to mean that the standard introduces additional considerations in determining the application of accounting standards. (CLA, Eide Bailly)
- In relation to EMIs, one commenter believes there should be consideration of a separate concept of component performance materiality. For example, an EMI that is 30% owned by the group should not have a component performance materiality of a comparative 100% owned component, as the risk of aggregated misstatements and risk of material misstatement represented by the 30% ownership is significantly less than another component of the same size. Expansion on determining component performance materiality for EMI would be helpful. (SL)

For ease of reference, the application material in paragraphs A47–A49 of the proposed SAS is as follows:

A47. In some circumstances, the group auditor may be able to overcome restrictions on access to information or people. Examples follow:

- If access to component management or those charged with governance of the component is restricted, the group auditor may request group management or those charged with governance of the group to assist with removing the restriction or otherwise request information directly from group management or those charged with governance of the group.
- If the group has a noncontrolling interest in an entity that is accounted for by the equity method, the group auditor may determine whether provisions exist (for example, in the terms of joint venture agreements or the terms of other investment agreements) regarding access by the group to the financial information of the entity and request group management to exercise such rights.

- If the group has a noncontrolling interest in an entity that is accounted for by the equity method and the group has representatives who are on the executive board or are members of those charged with governance of the noncontrolled entity, the group auditor may inquire whether they can provide financial and other information available to them in these roles.

A48. If the group has a noncontrolling interest in an entity that is accounted for by the equity method and the group auditor's access to information or people at the entity is restricted, the group auditor may be able to obtain information to be used as audit evidence regarding the entity's financial information, for example, from the following:

- Financial information that is available from group management because group management also needs to obtain the noncontrolled entity's financial information in order to prepare the group financial statements
- Publicly available information, such as audited financial statements, public disclosure documents, or quoted prices of equity instruments in the noncontrolled entity
- Financial statements audited by a referred-to auditor when the group auditor makes reference to the audit of a referred-to auditor in the auditor's report on the group financial statements

It is a matter of professional judgment, particularly in view of the assessed risks of material misstatement of the group financial statements and considering other sources of information that may corroborate or otherwise contribute to audit evidence obtained, whether the auditor can obtain sufficient appropriate audit evidence.

A49. If the group has a noncontrolling interest in an entity that is accounted for by the equity method and access to information or people at the entity is restricted, the group auditor may consider whether such restrictions are inconsistent with group management's assertions regarding the appropriateness of the use of the equity method of accounting.

The amended Appendix B, "Audit Evidence Regarding Valuation of Investments Based on Investee Financial Results," of PCAOB AS 1105, *Audit Evidence*, has been provided to the Board as Agenda Item 3D.

Additional Information

Prior to extant AU-C 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* becoming effective in 2012, the AU-Cs contained requirements that were similar to the PCAOB's (i.e., the ability to use audited financial statements as audit evidence for an investment accounted for using the equity method similar to investments in securities when valuations are based on the investee's financial results in extant AU-C section 501, *Audit Evidence — Specific Considerations for Selected Items* -see Agenda Item 3E). With the issuance of extant AU-C 600, it was clarified that equity method investments were considered "components", and paragraph AU-C 600.A23 elaborates on the ability to use audited financial statements as audit evidence, as follows:

A23. When access to information is restricted by circumstances, the group engagement team may still be able to obtain sufficient appropriate audit evidence; however, this is less likely as the significance of the component increases. For example, the group engagement team may not have access to those charged with governance, management, or the auditor (including relevant audit documentation sought by the group engagement team) of a component that is accounted for by the equity method of accounting. If the component is not a significant component and the group engagement team has a complete set of financial statements of the component, including the auditor's report thereon, and has access to information kept by group management regarding that component, the group engagement team may conclude that this information constitutes sufficient appropriate audit evidence regarding that component. If the component is a significant component, however, and the auditor of the group financial statements is not making reference to the audit of a component auditor in the auditor's report on the group financial statements, then the group engagement team will not be able to comply with the requirements of this section that are relevant in

the circumstances of the group audit. For example, the group engagement team will not be able to comply with the requirement in paragraphs .57–.58 to be involved in the work of a component auditor. Therefore, the group engagement team will not be able to obtain sufficient appropriate audit evidence regarding that component. The effect on the auditor’s report of the group engagement team’s inability to obtain sufficient appropriate audit evidence is considered in terms of section 705, Modifications to the Opinion in the Independent Auditor’s Report.

Question for the ASB:

1. Does the Board want the Task Force to align the requirements related to EMIs in the proposed SAS with PCAOB AS 1105, Appendix B?
2. If the Board wants to align with the requirements of the PCAOB, does the Board want to remove EMIs from the Proposed SAS and update AU-C 501 to address EMIs?

(Note that there were additional comments and suggestions unrelated to this question to the Board, that will be addressed by the Task Force at a future date.)

Issue 2: Practicality of Certain Requirements Related to Referred-to Auditors and Consideration of Alignment with PCAOB Standards

Request for Comment 10: Retaining the Option to Make Reference

Question 10. Do you support retaining the option that exists in extant AU-C section 600 for the group engagement partner to make reference to the audit of a referred to auditor (a component auditor per extant AU-C section 600) in the auditor’s report on the group financial statements?	No. of Responses
Yes	19
No comment	3
No. of comment letters	22

Request for Comment 11: Requirements Related to Referred-to-Auditors

Question 11. Are the specific requirements relating to referred to auditors clear, appropriate, and easily identifiable within the proposed SAS, including when considering exhibit A?	No. of Responses
Yes	13
Yes with suggestions	3
No	2
No comment	4
No. of comment letters	22

Two of the 18 commenters who responded to question 11 believe that the requirements are not clear, appropriate, or easily identifiable for the following reasons:

- The commenter struggled to identify the requirements that would apply when component auditors and referred-to auditors are involved without reliance on the exhibit. To enhance the readability and ease of use, the commenter suggested that the ASB consider the following options:
 - Issue a separate standard that includes the requirements and application material for circumstances in which reference is made to the audit of a referred-to auditor in the auditor’s report on the group financial statements: The PCAOB took this approach in its proposal [and also in its final standard], since the referred-to auditor has a different level of supervision than an “other auditor” (a term that is akin to component auditor) and is not part of the engagement team.
 - Present the requirements for circumstances in which reference is made to the audit of a

referred-to auditor in the auditor's report on the group financial statements as a separate section within the SAS: Though this would create some repetition in the proposed standard (i.e., requirements that apply to both the involvement of component auditors and referred-to auditors), it would enhance the clarity of the requirements and application when using a referred-to-auditor. (EY)

- The requirements in the proposed SAS appear to be more restrictive than the requirements in AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*, in [PCAOB Release 2022-002](#) when dealing with referred-to auditors. AS 1206 does not contain a requirement to communicate significant risks to referred-to auditors, while the proposed SAS requires that the group auditor communicate significant risks that are relevant to the referred-to auditor. There may be practical challenges with this and other requirements (e.g., determining that referred-to auditors have the appropriate competence and capabilities) based on the level of access and communication the group engagement team is able to have with a referred-to auditor. In the PCAOB's proposed standard, there are inquiries of, and representations from, the referred-to auditor; however, the expectation of the two-way dialogue between the group auditor and the referred-to auditor is substantially less than what would be anticipated between the group auditor and the component auditor. (PwC)
- The commenter questions whether the effort required by the proposed SAS is necessary for nonissuers audited under ASB standards as compared to issuers audited under PCAOB standards. Because the concept of referred-to auditors is unique to the US environment, the commenter encourages the ASB to seek closer alignment with the PCAOB in setting its requirements. (PwC)
- The construct of the standard results in a level of repetition that might render it unclear. Clarifications to the wording and ordering of certain requirements would better follow the flow of the audit process and assist the auditor's judgment in first deciding whether it is appropriate to make reference, and then how to do so. The commenter believes that the ASB could seek to reduce the degree of duplication between a number of requirements, specifically in relation to independence and relevant ethical requirements, offers some drafting suggestions in Appendix 2 of its comment letter, but believes there may be further opportunities to streamline. (PwC)

Background on the Issue

Recap of Prior Board Meetings

During the July 2021 Board Meeting, the Board discussed the following:

- Retaining the option in extant AU-C 600 for the group auditor to make reference to the audit of a component auditor in the auditor's report on group financial statements (making reference)
- The conclusion by the Task Force that the main paragraphs in extant AU-C 600 (paragraphs 24-31 and related application material) that address making reference do not need revision, and that other paragraphs within extant AU-C 600 that mention making reference do not need revision (other than conforming changes as a result of converging with ISA 600).

The Board agreed with the direction stated in the two bullets above.

At the October 2021 Board Meeting, the direction to the Task Force from the Board was to consider developing a separate proposed SAS that would be applicable only when the group auditor is making reference, to make it clear that the requirements that are applicable when making reference generally differ from the requirements that are applicable when the group auditor is assuming responsibility.

At the January 2022 Board Meeting, the Task Force informed the Board that, after much deliberation and consideration concerning how to achieve the objectives stated by the ASB at its October meeting, the Task Force decided to take a slightly different approach than the one recommended by the ASB (i.e.,

developing a separate standard) and instead included all the paragraphs related to making reference (except for a very few) together in one section towards the end of a single proposed SAS. This approach does the following:

- Accomplished the objective of the ASB
- Enabled the Task Force to avoid making pervasive changes to ISA 600 (Revised) to accommodate text related to referred-to auditors because the making reference paragraphs are located in a separate section towards the end of the proposed SAS rather than being interspersed throughout the document
- Eliminated the potential confusion that might exist concerning which SAS applies in which circumstance, considering the proposed SAS focused on group audits as a whole (e.g., it includes requirements and guidance on risk assessment and performing further auditor procedures, while the recent PCAOB standards focus on the use of other auditors (i.e., mainly the direction and supervision of other auditors))
- Resulted in a streamlined and easy to follow standard, both when assuming responsibility and also when making reference

The Board was in agreement with the proposed approach.

PCAOB Requirements When Making Reference

On June 21, 2022, the PCAOB adopted AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*. Agenda Item 3C has been provided to the Board and is a replication of AS 1206. In addition to AS 1206, the PCAOB also adopted additional amendments to AS 2101, *Audit Planning*, that are applicable when dividing responsibility, as follows:

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

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

- a. The nature and amount of assets, liabilities, and transactions executed at the location or business unit, including, e.g., significant transactions that are outside the normal course of business for the company or that otherwise appear to be unusual due to their timing, size, or nature ("significant unusual transactions") executed at the location or business unit;
- b. The materiality of the location or business unit;
- c. The specific risks associated with the location or business unit that present a reasonable possibility of material misstatement to the company's consolidated financial statements;
- d. Whether the risks of material misstatement associated with the location or business unit apply to other locations or business units such that, in combination, they present

a reasonable possibility of material misstatement to the company's consolidated financial statements;

- e. The degree of centralization of records or information processing;
- f. The effectiveness of the control environment, particularly with respect to management's control over the exercise of authority delegated to others and its ability to effectively supervise activities at the location or business unit; and
- g. The frequency, timing, and scope of monitoring activities by the company or others at the location or business unit.

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

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

.14 In an audit that involves other auditors or referred-to auditors, the lead auditor should perform the procedures in paragraphs .11–.13 of this standard to determine the locations or business units at which audit procedures should be performed.

Additionally, Section 4140, "Principal Auditor," of the SEC's *Financial Reporting Manual* also has additional guidance that is applicable in a scenario where reference is being made in the audit report an issuer to another auditor. The various PCAOB standards that address group audits (or multilocation audit engagements) illustrate the different structure used by the PCAOB in comparison to the proposed SAS, which aligns with international standards.

Commenter Views

Based on analysis of the comment letters, the following was noted:

- One commenter (EY) appears to suggest following the PCAOB's approach of placing the requirements for situations in which the auditor is making reference in a separate standard.
- One commenter (PWC) appears to suggest that the proposed SAS should align more closely with PCAOB AS 1206.

The Task Force notes that commenters had additional suggestions on the flow of the paragraphs related to making reference, as well as drafting suggestions. The Task Force intends to analyze and address these comments at a future meeting.

Questions for the ASB

1. Does the Board continue to agree with the approach taken in the proposed SAS as it relates to incorporating the requirements for making reference in a single SAS (i.e., a separate SAS applicable only when making reference is not necessary)?
2. Does the Board want the Task Force to either:
 - a. Explore aligning the requirements related to making reference in the proposed SAS with PCAOB AS 1206? As there are areas where differences exist between the proposed SAS and AS 1206, how does the Board suggest the Task Force proceed in making determinations as to which differences should remain or which differences are eliminated?
 - b. Maintain the approach of keeping the requirements related to making reference consistent with the extant standard, adjusted only as necessary to be consistent with the proposed

SAS?

Issue 3: Considering the Magnitude of the Portion of the Financial Statements Audited by Referred-to Auditors in Determining Whether Sufficient Appropriate Audit Evidence Can Reasonably be Expected to be Obtained

Request for Comment 12: Considering Magnitude of Portion of Financial Statements Audited by Referred-To-Auditor When Determining Whether Sufficient Appropriate Audit Evidence Can Reasonably Be Expected to Be Obtained

Question 12. Is the last sentence of paragraph A41 clear? Is there additional application material that is needed, and if so, what should it be?

Explanation: The last sentence of par. A41 of the ED states, “As the magnitude of the portion of the financial statements that is audited by referred-to auditors increases, it is less likely that the group engagement partner can conclude that sufficient appropriate audit evidence can be obtained.”

Question 12: Is the last sentence of paragraph A41 clear?	No. of Responses
Yes	5
Yes with suggestions	1
No	13
No comment	3
No. of comment letters	22

Question 12: Is there additional application material that is needed, and if so, what should it be?	No. of Responses
OK as is	3
Additions	9
No comment	10
No. of comment letters	22

Summary of Commenter Responses

Thirteen of the nineteen commenters who responded to this question indicate that the last sentence of par. A41 is not clear and provided the following additional comments about that sentence:

- Five commenters found this sentence to be problematic because, in the government auditing environment, it is not uncommon for referred-to auditors to perform a substantial percentage of the audit work. They believe that, if the procedures outlined in paragraphs 51 – 66 related to making reference are adhered to and adequately documented, there is no reason why magnitude alone should imply that sufficient appropriate audit evidence could not be obtained by the group engagement partner. (COV, MI OAG, NSAA, VSCPA, Eide Bailly)
- Two commenters suggested that the ASB add a “Consideration Specific to Governmental Entities” paragraph to address the magnitude concept with relation to opinion units in a governmental environment or expand paragraph A43 to more clearly address magnitude considerations related to opinion units. (COV, MI OAG)
- To avoid diversity in practice, four commenters recommended that a better delineation be made (in numbers or words) to identify where the threshold is for concluding that the group engagement partner cannot make reference to a referred-to auditor. (E&Y, TXCPA, OSCPA, CLA). One commenter suggested that the SAS provide a figure as a starting point in the SAS to help drive

consistency in practice and noted that consistency is especially relevant, as this matter involves the coordination of different firms. The commenter recommended that the following language from par. .06A of PCAOB AS 2101, *Audit Planning*, be added: (E&Y)

In addition, 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.

Commenters requested clarification or application guidance regarding the following matters:

- Certain qualitative factors can be important considerations for determining whether the group auditor can obtain sufficient appropriate audit evidence on which to base an opinion on the group financial statements. Provide additional considerations for the group engagement partner, such as the location of group operations and group management, and the extent of the group engagement team's knowledge of the overall financial statements and familiarity with the group. (GT)
- Clarify that the group engagement partner's assessment of the magnitude of the portion of the financial statements audited by the referred-to auditor includes quantitative and qualitative (emphasis added) considerations relating to the financial information and disclosures that could reasonably be expected to influence the economic decisions of users of the group financial statements. (BDO)
- To avoid a strictly monetary interpretation of magnitude, add a phrase to the final sentence that incorporates the need to consider the qualitative magnitude of risks vs. solely the quantitative magnitude of the portion of the financial statements audited by the referred-to auditors. (TIC)
- Both extant AU-C section 600 and the first bullet in paragraph A41 of the proposed SAS use the term "financial significance." It is unclear if "magnitude" is intended to have a different meaning from "financial significance" and, if so, what that meaning is. Additional, or revised, application material clarifying the intended meaning of "magnitude" would add to greater understanding of the intent of paragraph A41. (Mazars)
- Clarify whether the considerations in par. A41, including the financial significance of the components and risks of material misstatements to the group financial statements associated with the components, also apply when component auditors are involved. Clarify whether there would ever be an instance where the component audited by a component auditor would be too significant, as determined by various criteria, for the group auditor to obtain sufficient appropriate evidence. (E&Y)

Question for the ASB

1. When considering the magnitude of the portion of the financial statements audited by referred-to auditors in determining whether sufficient appropriate audit evidence can reasonably be expected to be obtained, which of the following should the Task Force explore?
 - a. Developing additional application guidance addressing both quantitative and qualitative factors for the group auditor to evaluate when considering the magnitude or the portion of the financial statements audited by referred-to auditors? If so, what are those additional factors?
 - b. Specifying a "bright-line" quantitative threshold for the group auditor to use when considering the magnitude or the portion of the financial statements audited by referred-to auditors (e.g., PCAOB AS 2101.06A has a threshold of 50%)?

Issue 4: Recommendation for PEEC to Align with the IESBA Project and to Clarify Independence Requirements for Group Audits

Unrelated to a specific request for comment in the ED, five commenters (Deloitte, EY, GT, KPMG, PWC) provided comments related to an ongoing International Ethics Standards Board for Accountants (IESBA) project.

In February 2022, the IESBA released the Exposure Draft *Proposed Revisions to the Code Relating to the Definition of Engagement Team and Group Audits* (IESBA ED), with proposed revisions to the International Code of Ethics for Professional Accountants (the IESBA Code). The proposed revisions establish provisions that comprehensively address independence considerations for firms and individuals involved in an engagement to perform an audit of group financial statements. The proposals also address the independence implications of the change in the definition of *engagement team*, a concept central to an audit of financial statements, in ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*. Among other matters, the proposals do the following:

- Establish new defined terms and revise a number of existing terms, including for application with respect to independence in a group audit context
- Clarify and enhance the independence principles that apply to
 - individuals involved in a group audit.
 - firms engaged in the group audit, including firms within and outside the group auditor firm's network.
- More explicitly set out the process to address a breach of an independence requirement at a component auditor firm, including reinforcing the need for appropriate communication between the relevant parties and with those charged with governance of the group.
- Align a number of provisions in the Code to conform to changes in the IAASB's Quality Management standards.

Commenters acknowledged the status of the IESBA project and provided the following urgent recommendations:

- The Professional Ethics Executive Committee ("PEEC") of the AICPA should actively monitor the IESBA project.
- PEEC should undertake a project to revise the AICPA's Code of Professional Conduct and evaluate convergence with the IESBA Code.
- The ASB and PEEC should consider the interaction of the IESBA ED and the proposed group audit SAS as it relates to compliance with ethical requirements, including those related to independence, particularly with regard to non-network component auditors involved in a group audit.

Questions for the ASB

1. Does the Board agree that it is urgent for the ASB and PEEC to engage in order to respond to the commenter recommendations?
2. What are the Board's views on the timeline and ability to vote on a final standard, and whether there are dependencies on PEEC actions (e.g., a PEEC exposure draft)?
3. If yes, how does the ASB wish to proceed in engaging with PEEC?
4. If yes, how does the ASB wish for Task Force to proceed in assisting the ASB to engage with PEEC?

Summary of Comments on Proposed SAS *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-To Auditors)*.

Comment Letter Number	Abbreviation in Summary of Comments	Name of Commenter
1	CLA	CliftonLarsenAllen LLP
2	COV	Commonwealth of Virginia
3	NSAA	National State Auditors Association
4	MI OAG	Michigan Office of the Auditor General
5	GAO	U.S. Government Accountability Office
6	ICPAS	Illinois CPA Society
7	RSM	RSM US LLP
8	VSCPA	Virginia Society of CPAs
9	Crowe	Crowe LLP
10	Mazars	Mazars LLP
11	OSCPA	Ohio Society of CPAs
12	Eide Bailly	Eide Bailly LLP
13	TXCPA	Texas Society of CPAs
14	Deloitte	Deloitte & Touche LLP
15	TIC	AICPA Technical Issues Committee
16	GT	Grant Thornton LLP
17	KPMG	KPMG LLP
18	PwC	PricewaterhouseCoopers LLP
19	EY	Ernst & Young LLP
20	BDO	BDO USA LLP
21	SL	SingerLewak LLP
22	John Keyser	John D. Keyser, PhD, CPA, CFE

Responses to Questions 1a – 13

Overall Opinion	Commenter	Comment	Response to Comment
1a. Does the proposed SAS have appropriate linkages to other AU-C sections and to the proposed SQMSs?			
Yes	RSM	We believe the proposed SAS has appropriate linkages to other AU-C sections and to the proposed SQMSs.	
Yes	BDO	Yes, the proposed SAS provides appropriate linkages to other AU-C sections.	
Yes	CLA	We believe the proposed SAS has appropriate linkages to other AU-C sections and to the proposed SQMS. We found these linkages especially helpful when considering ethical responsibilities of component auditors.	
Yes	COV	The proposed SAS linkages to other AU-C sections are appropriate. While we are not opposed to the linkages to the proposed SQMSs, we believe they are unlikely to have a significant effect on quality. They do, however, increase the length of the standard and potentially set precedent for future standard setting.	
Yes	Crowe	We believe the linkages and references to the proposed QM SAS, proposed SQMSs, and other relevant AU-C sections are appropriate and effective.	
Yes	Deloitte	Yes. D&T believes the proposed SAS has clear and appropriate linkages to other AU-C sections and the proposed SQMSs.	
Yes	Eide Bailly	We believe that the proposed SAS has appropriate linkages to other AU-C Sections and to the proposed SQMS standards throughout the document.	
Yes	EY	The proposed SAS generally has appropriate linkages with other standards.	
Yes	GAO	Our review of the proposed Statement on Auditing Standards (SAS) found that the linkage to other AU-C sections and to the proposed Statement on Quality Management Standards (SQMS) is sufficient.	
Yes	GT	We believe the linkages in the proposed SAS are helpful and appropriate.	
Yes	ICPAS	We believe the linkages are appropriate.	
Yes	Mazars	Yes, the proposed SAS has appropriate linkages to other AU-C sections and to the proposed SQMSs.	
Yes	MI OAG	Yes, we consider the linkages as appropriate and offer no suggested changes.	
Yes	NSAA	The proposed linkages are appropriate.	
Yes	OSCPA	The committee felt that linkages were clear and did not identify omissions.	
Yes	PwC	We generally believe the proposed SAS has appropriate linkages to other AU-C sections and to the SQMSs.	
Yes	SL	Yes, the proposed SAS as the appropriate linkage and revisions to other sections where applicable.	
Yes	TIC	Yes, a considerable amount of direct linkage within the standard and application material was noted by TIC.	
Yes	TXCPA	The proposed SAS has appropriate linkages to other AU-C sections and to the SQMSs.	
Yes	VSCPA	The Committee believes the proposed SAS provides the appropriate linkages to other AU-C sections and to the proposed SQMSs.	
Yes	BDO	[The proposed SAS provides] adequate emphasis that the proposed SAS builds on the requirements within other AU-C sections, including the proposed QM SAS.	

Overall Opinion	Commenter	Comment	Response to Comment
Suggestions	GT	There are a variety of areas that we believe can be enhanced by additional application material or clarification of the language used in the requirements.	
Suggestions	PwC	There are some areas that could be further clarified within the proposed SAS, and additional special considerations in a group audit that the ASB could explore.	
1b. Does the proposed SAS sufficiently address the special considerations in a group audit as they relate to applying the requirements and application material in other relevant AU-C sections, including the proposed QM SAS? Are there other special considerations for a group audit that you believe have not been addressed in the proposed SAS?			
Yes	CLA	Overall, we believe the proposed SAS sufficiently addresses special considerations in a group audit.	
Yes	COV	The proposed SAS sufficiently addresses the special considerations of a group audit as they relate to applying the requirement.	
Yes	Crowe	We also believe the special considerations in a group audit are sufficiently included and addressed in the proposed SAS.	
Yes	Deloitte	[The proposed SAS] sufficiently addresses the special considerations in a group audit as they relate to applying the requirements and application material in other relevant AU-C sections including the proposed QM SAS.	
Yes	Eide Bailly	The proposed SAS sufficiently addresses the special considerations in a group audit as they relate to applying the requirements and application material in other relevant AU-C sections, including the proposed QM SAS.	
Yes	EY	[The proposed SAS] adequately addresses special considerations in a group audit as they relate to applying the requirements and application materials in other relevant AU-C sections.	
Yes	GAO	We believe that the proposed SAS sufficiently addresses the special considerations in a group audit with respect to applying the requirements and application material in other relevant AU-C sections.	
Yes	Mazars	Except as discussed below, the proposed SAS sufficiently addresses the special considerations in a group audit as they relate to applying the requirements and application material in other relevant AU-C sections, including the proposed QM SAS.	
Yes	MI OAG	Yes, the proposed SAS appropriately applies the requirements and application materials of the other relevant AU-C sections.	
Yes	NSAA	The proposed SAS sufficiently addresses the special considerations of a group audit as they relate to applying the requirement.	
Yes	RSM	We believe the proposed SAS sufficiently addresses the special considerations in a group audit as they relate to applying the requirements and application material in other relevant AU-C sections, including proposed Statement on Auditing Standards, <i>Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards</i> (the proposed QM SAS).	
Yes	SL	Yes, the proposed SAS sufficiently addresses the special considerations in a group audit, as it relates to other AU-C sections, and the QM SAS.	
Yes	TIC	Yes, TIC believes applicable elements as well as details about who is in or out of scope given the various scenarios are sufficiently addressed in the proposed SAS.	
Yes	TXCPA	The proposed SAS has sufficiently addressed the special considerations pertaining to other relevant AU-C sections and the proposed SQMSs.	
Yes	VSCPA	The proposed SAS sufficiently address the special considerations in a group audit.	
1b. Are there other special considerations for a group audit that you believe have not been addressed in the proposed SAS?			

Overall Opinion	Commenter	Comment	Response to Comment
OK as is	COV	[We] do not have any additional special considerations for a group audit that were not addressed.	
OK as is	Eide Bailly	We don't have additional special considerations for a group audit that haven't already been addressed.	
OK as is	MI OAG	We have not identified any other considerations to be addressed.	
OK as is	NSAA	[We] do not have any additional special considerations for a group audit that were not addressed.	
OK as is	RSM	We are not aware of any other special considerations for a group audit that have not been addressed in the proposed SAS.	
OK as is	SL	We are not aware of other special considerations that have not been addressed.	
OK as is	TIC	No additional special considerations were noted by TIC.	
OK as is	TXCPA	The PSC believes that all relevant considerations for a group audit have been addressed in the proposed SAS.	
Suggestions	GT	<p>We ask the Board to consider the following items related to the proposed QM SAS (now SAS 146).</p> <ul style="list-style-type: none"> • Paragraph 31b – We believe this paragraph requires additional guidance to assist auditors in understanding how to accomplish such a review in a group audit. We do not believe it is practical to assume that an auditor can summarize all significant judgments for an engagement partner to review directly. Instead, we believe it is more operational for the engagement partner to take responsibility for such reviews with the assistance from others. • Paragraph 34 – This paragraph could also be enhanced with application guidance specific to group audits as it may be difficult for the group engagement partner to be aware of all formal communications made by a component auditor to (1) management, (2) those charged with governance, or (3) regulatory authorities, some of which may also not pertain to the audit of the group financial statements. • Paragraph 41b – It is unclear how this requirement interacts with paragraph 76 of the group audits proposed SAS. We believe application guidance that addresses this interaction and the expectations for the group engagement partner regarding component consultations would be beneficial. <p>In addition, we encourage the Board to add the following language to paragraph A14 of the new Statement on Quality Management Standards (SQMS) 1 to help bridge the gap between guidance provided in SAS 146 and the application of such guidance in the other sets of standards that would be subject to SQMS 1.</p> <p style="padding-left: 40px;">Referred-to auditors are not members of the engagement team. Referred-to auditors are not component auditors. Likewise, in an examination or review engagement, when a firm determines to make reference to the examination or review of another auditor, accountant, or practitioner, the other auditor also is not a member of the engagement team.</p> <p>We also recommend adding the following guidance in paragraph A91 of SQMS 1 to further clarify the various resources that may be used in an engagement subject to SQMS 1.</p> <p style="padding-left: 40px;">Determining whether another auditor, accountant, or practitioner is a resource or an information source depends on the particular circumstances. For example, a component auditor is a</p>	

Overall Opinion	Commenter	Comment	Response to Comment
		<p>resource used in performing a group audit, but a referred-to auditor is an information source, as a referred-to auditor's report provides information to be used as audit evidence. Similarly, a service auditor that issues a report on a service organization's controls is an information source and not a resource, unless the service organization is requested to perform further procedures for purposes of the particular engagement. A predecessor auditor, accountant, or practitioner is not a resource.</p>	
Suggestions	ICPAS	<p>We question how a group auditor gains comfort with a component auditor of a foreign company that conducts the audit in a foreign language. Although supervision and communication with the different component auditors are discussed in paragraphs A82-A85, overcoming language barriers is not specifically addressed. We suggest application guidance as to the approach to dealing with this situation (such as using an intermediary to interpret) and related supervision requirements as well as guidance regarding a situation where a client wants to use a local firm that speaks a different language than the group auditor. We refer to our response in #4 regarding the impact of different firm methodologies.</p>	
Suggestions	Mazars	<p>Paragraph 74b. includes a requirement to communicate with those charged with governance of the Group "instances where the group auditor's review of the work of a component auditor gave rise to concern about the quality of that component auditor's work, and how the group auditor addressed the concern." While we believe this requirement is intended to be a follow up to the requirement in paragraph 74a. related to communication of planned involvement in the work to be performed by component auditors, we are concerned that the standard, as written, will lead to inconsistent application. We expect that the interpretation of what rises "to a concern about the quality of that component auditor's work" will be inconsistently applied given the lack of application material and that there may be unconscious bias in that judgement when assessing component auditors from the group auditor's firm or network versus when the component auditor in an unrelated, competitor firm. As a result, we are concerned that the standard will not fully achieve its intentions related to communications with those charged with governance.</p>	
1c. Does the proposed SAS result in a group audit that achieves the objectives of the proposed QM SAS?			
Suggestions	PwC	<p>There are some areas that could be further clarified within the proposed SAS, and additional special considerations in a group audit that the ASB could explore, to ensure the proposed SAS achieves the ASB's objectives in revising it as well as the objectives of SAS 146.</p> <p>It is important that the requirements in the proposed SAS are clear insofar as how they interact with requirements in the newly approved quality management standards, particularly SAS 146, <i>Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards</i> (referred to in the question as the QM SAS) and the new Statement on Quality Management Standards (SQMS) 1, <i>A Firm's System of Quality Management</i>. In our view, the application material in the proposed SAS is helpful to understand how the requirements in both SAS 146 and the proposed SAS are to be applied in the context of group audits. However, due to the complexities that may exist in a group audit, it is likely questions will arise during the implementation of SAS 146 and the proposed SAS, in particular with respect to direction, supervision and review of the work of component auditors. We encourage the ASB to monitor questions and issue additional guidance, if necessary, about how</p>	

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		<p>the requirements in SAS 146 would be applied in a group audit. After the proposed SAS is implemented, the ASB should seek feedback from the Peer Review Board and others to understand whether the proposed SAS and SAS 146 are achieving their intended objectives.</p> <p>As we noted in our response to the exposure draft of the proposed quality management standards, today’s audits are being performed with increasingly diverse and distributed delivery models that leverage technology, other tools, and working practices to increase the effectiveness and efficiency of audit work. As entities and audits become more distributed, it is often necessary to involve others, such as component auditors, to assist the engagement partner in directing, supervising, and reviewing the engagement.</p> <p>Effective interaction between the group auditor and component auditors is important to audit quality, and we agree that the engagement partner needs to be sufficiently and appropriately involved throughout the audit to be able to take overall responsibility for the quality of the group audit engagement. However, we think it important that there be shared accountability for quality when firms use component auditors.</p> <p>We agree with the following points highlighted in SAS 146:</p> <ul style="list-style-type: none"> ● AU-C section 600 provides guidance on how to adapt and apply the requirements of SAS 146 in an audit of group financial statements involving component auditors. ● When others such as component auditors perform supervisory and review activities, the outcomes of those activities can be taken into account by the engagement partner in fulfilling their responsibilities in SAS 146. For example, the engagement partner may find it necessary to seek input from others with responsibilities for direction, supervision, and review to make determinations (i) about whether sufficient and appropriate resources are assigned or made available to the engagement team in a timely manner; and (ii) that members of the engagement team and others collectively have the appropriate competence and capabilities, including sufficient time, to perform the audit engagement. ● The group engagement partner exercises professional judgment when determining the nature and extent of the review of component auditor work in a group audit. <p>We also agree with retaining the US concept of dividing responsibility by making reference to another auditor’s opinion on the audit of a component in the group auditor’s report on the group financial statements. We agree it is helpful for the ASB to develop a new definition of a “referred to auditor” and to clarify that they are not considered a component auditor and therefore note part of the engagement team for a group audit.</p> <p>The proposed SAS generally appears to result in a group audit that achieves the objectives of SAS 146, and strikes an appropriate balance between the responsibilities of the group engagement team and component auditors. However, we encourage the ASB to consider whether it is sufficiently clear</p>	

Agenda Item 3A – Group Audits, Comment Letter Summary

Overall Opinion	Commenter	Comment	Response to Comment
		that component auditors are responsible for the performance of their work in accordance with AICPA standards, in particular SAS 146.	
Yes	CLA	We believe the proposed SAS will help auditors in effectively managing quality at the group engagement level and, as a result, achieve the objectives of the proposed QM SAS.	
Yes	COV	We believe the proposed SAS results in a group audit that achieves the objectives of the proposed QM SAS	
Yes	Deloitte	[The proposed SAS] results in a group audit that achieves the objectives of the proposed QM SAS.	
Yes	Eide Bailly	The objectives of the proposed QM SAS are achieved within the proposed SAS for group audits.	
Yes	EY	[The proposed SAS] achieves the objectives of the proposed QM SAS.	
Yes	GAO	We also believe that the proposed SAS results in a group audit that achieves the objectives of the proposed SQMS.	
Yes	ICPAS	Yes, we believe so.	
Yes	Mazars	Yes, we believe the proposed SAS results in a group audit that achieves the objectives of the proposed QM SAS.	
Yes	MI OAG	Yes, we think it will.	
Yes	NSAA	We believe the proposed SAS results in a group audit that achieves the objectives of the proposed QM SAS.	
Yes	RSM	We believe meeting the requirements of the proposed SAS should result in a group audit that achieves the objectives of the proposed QM SAS.	
Yes	SL	Yes, the proposed SAS will result in a group audit that achieves the objectives of the proposed QM SAS.	
Yes	TIC	Yes, TIC believes the objectives of the proposed SAS are achieved.	
Yes	TXCPA	The proposed SAS supports the objectives of the proposed QM SAS.	
Yes	VSCPA	The proposed SAS results in a group audit that achieves the objectives of the proposed QM SAS.	
Suggestions	PwC	<p>We generally believe the proposed SAS sufficiently addresses the special considerations in a group audit, with the exception of our views that follow on (i) changes to the definition of engagement team with respect to independence and ethics in a group audit; (ii) how the engagement partner can direct, supervise, and review the work of a component auditor that is not part of the same network as the group engagement team; and (iii) considerations relating to sharing audit evidence across the group audit.</p> <p><i>Implications of changes to the definition of engagement team with respect to independence and ethics in a group audit</i></p> <p>We believe the implications of the change in SAS 146 to include component auditors within the definition of engagement team are unclear, particularly in terms of compliance with independence and ethical requirements. While group auditors and component auditors today communicate about breaches of independence requirements, the variety of ethical requirements that could apply in a group audit may present legal and other challenges that have not been fully considered (e.g., in relation to confidentiality and sharing of information). This is likely to be heightened when component auditors are not from within the same network as the group engagement team – such circumstances are increasing as a result of mandatory audit firm rotation in some jurisdictions.</p>	

Overall Opinion	Commenter	Comment	Response to Comment
		<p>We note that the International Ethics Standards Board for Accountants (IESBA) has a current project to align the definition of the term “engagement team” in its International Code of Ethics for Professional Accountants with the revised definition in ISA 220 (Revised),¹ and establish provisions that comprehensively address independence considerations for firms and individuals involved in a group audit. We believe it is urgent for the PEEC to determine and conclude on whether there are implications to the AICPA’s Code of Professional Conduct as a result of the IESBA’s work and the changes to the definition of the engagement team in SAS 146. Changes to the AICPA Code of Professional Conduct could result in the need for additional guidance to enable auditors to consistently apply the requirements in the standards. A coordinated approach between the ASB and PEEC to consider their respective standards and guidance that is finalized before SAS 146 and the proposed SAS become effective will be essential.</p> <p><i>Execution of responsibilities related to direction, supervision, and review when the component auditor is not part of the same network</i></p> <p>It would be helpful to add additional application material to paragraph A81 to assist engagement partners in complying with paragraph 30 of the proposed SAS, which discussed the engagement partners’ responsibility for the nature, timing, and extent of direction, supervision, and review when component auditors are from non-network firms. While paragraphs A23-A24 of SAS 146 note that the engagement partner may need to take different actions when dealing with an individual from another firm, this application material is focused solely on understanding competence, capabilities, compliance with ethical requirements, and independence and not other aspects of SAS 146.</p> <p>In principle, when a component auditor is not part of the same network, we would expect that efforts to understand matters such as the competence and capabilities of the component auditor would focus on inquiry, knowledge of and prior experience with the component auditor, and consideration of publicly-available information that might indicate concerns with the quality of the component auditor’s work (including communications regarding the component auditor’s professional competence from professional bodies, licensing authorities, or other third parties). Importantly, the nature and extent of these efforts will depend on how the component auditor is being used and the facts and circumstances of the engagement. Communications from the component auditor would also be taken into account. If based on this, the group auditor has concerns about the competence and capabilities of the component auditor, the planned involvement in the work of the component auditor would likely increase, or the group auditor might ultimately conclude it is inappropriate to use the component auditor.</p> <p>To facilitate consistent application in practice when the component auditor is not part of the same network (and therefore may not be subject to the same policies and procedures), the ASB could consider developing application guidance that incorporates the following:</p>	

¹ ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*

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		<ul style="list-style-type: none"> ● At the commencement of the engagement, communication with the component auditor regarding their own responsibilities for direction, supervision, and review in accordance with SAS 146 and obtaining acknowledgement of compliance ● Throughout the audit, understanding the areas on which the engagement partner at the component has devoted attention ● Similar to paragraph 28 of the proposed SAS, considering whether publicly-available information about the results of the monitoring and remediation process or external inspections related to the component auditor indicate there may be specific concerns related to direction, supervision, and review <p>There may be other considerations that could be addressed when the group auditor and component auditor are not part of the same network and therefore do not have common systems of quality management, including in relation to the group auditor’s consideration of the use of technological resources. This may be an area where non-authoritative guidance outside of the proposed SAS may be helpful to explain what may be appropriate in the circumstances.</p> <p><i>Considerations relating to sharing audit evidence across the group</i></p> <p>While the proposed SAS seeks to clarify the role of shared service centers, we believe this is an area that may continue to give rise to questions. Increasing centralization of accounting and reporting processes into shared service centers by group entities means that audit work related to those processes also needs to be performed on a centralized basis to obtain audit evidence that will be relevant to group audits, audit work at components, and stand-alone statutory audits. This has implications for component audits, including with regard to how they can use evidence obtained from testing at a shared service center (which is often performed by the group auditor or another component auditor). This circumstance is not considered in the ISAs or existing AICPA standards. We believe there is merit in the ASB considering whether the proposed SAS or a separate project could address how component auditors across the group are able to demonstrate that they have fulfilled their responsibilities in relation to evaluating the sufficiency and appropriateness of the shared evidence without duplicating effort.</p>	
2. With respect to the structure of the proposed SAS, do you support the placement of sub-sections throughout the proposed SAS that highlight the requirements when component auditors are involved or when reference is made to the audit of a referred-to auditor in the auditor’s report on the group financial statements?			
Suggestions	GAO	It is helpful to users of the standard to include subsections on the requirements when component auditors are involved or when a referred-to auditor’s audit is mentioned in the auditor’s report on the group financial statements. The ASB can take additional measures to make the subsections related to component auditors and referred-to auditors clearer within the requirements. For example, using icons,	

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		<p>underlining, or other formatting could visually highlight the component auditor and referred-to auditor subsections.</p> <p>We believe that the proposed standard can be further clarified by making changes to the title and selected headings to enhance the auditor’s understanding and ensure continuity in terminology and interconnectedness within the standard.</p> <p>We also suggest that the ASB consider updating the headings in the proposed SAS to be consistent with and descriptive of the respective content and to enhance the auditors’ understanding and ability to apply the standards consistently. We suggest the following as possible considerations for improving clarity and consistency.</p> <table border="1" data-bbox="516 532 1732 971"> <thead> <tr> <th data-bbox="516 532 1121 581">Proposed SAS</th> <th data-bbox="1131 532 1732 581">GAO Proposal (in red text)</th> </tr> </thead> <tbody> <tr> <td data-bbox="516 589 1121 670">Scope of This Proposed Statement on Auditing Standard</td> <td data-bbox="1131 589 1732 670">Scope of This Proposed Statement on Auditing Standards (page 20)</td> </tr> <tr> <td data-bbox="516 678 1121 792">Evaluating the Component Auditor’s Communications and the Adequacy of The Work</td> <td data-bbox="1131 678 1732 792">Evaluating the Component Auditor’s Communications and the Adequacy of the Component Auditor’s Work (page 36)</td> </tr> <tr> <td data-bbox="516 800 1121 971">Exhibit A — Relevancy of Requirements in Various Group Audit Scenarios (Ref: par. 12, 58a, A64)</td> <td data-bbox="1131 800 1732 971">Exhibit A — Relevancy of Requirements in Various Group Audit Scenarios (Ref: par. 12, 58a, A164) (page 104)</td> </tr> </tbody> </table>	Proposed SAS	GAO Proposal (in red text)	Scope of This Proposed Statement on Auditing Standard	Scope of This Proposed Statement on Auditing Standard s (page 20)	Evaluating the Component Auditor’s Communications and the Adequacy of The Work	Evaluating the Component Auditor’s Communications and the Adequacy of the Component Auditor’s Work (page 36)	Exhibit A — Relevancy of Requirements in Various Group Audit Scenarios (Ref: par. 12, 58a, A64)	Exhibit A — Relevancy of Requirements in Various Group Audit Scenarios (Ref: par. 12, 58a, A164) (page 104)	
Proposed SAS	GAO Proposal (in red text)										
Scope of This Proposed Statement on Auditing Standard	Scope of This Proposed Statement on Auditing Standard s (page 20)										
Evaluating the Component Auditor’s Communications and the Adequacy of The Work	Evaluating the Component Auditor’s Communications and the Adequacy of the Component Auditor’s Work (page 36)										
Exhibit A — Relevancy of Requirements in Various Group Audit Scenarios (Ref: par. 12, 58a, A64)	Exhibit A — Relevancy of Requirements in Various Group Audit Scenarios (Ref: par. 12, 58a, A164) (page 104)										
Suggestions	GT	<p>We appreciated the “Considerations When Component Auditors Are Involved” subheadings and found them helpful. However, we felt the headings one level “below” those were easily lost, since they are the same font size and type as the paragraphs themselves. By way of example, refer to the heading above proposed paragraph 27. We ask the Board to consider whether different formatting, such as underlining, would be possible to enhance their visibility among the paragraphs. We feel the lack of visibility could create challenges for auditors attempting to navigate the requirements, especially as the Board continues to issue lengthier standards.</p>									
Yes	BDO	<p>We are supportive of the structure of the proposed SAS, and the placement of sub-sections therein. The placement of the sub-sections support the scalability objective of the standard, for example, in circumstances where component auditors are not involved in the group audit. Additionally, incorporating relevant considerations when component auditors are involved throughout the proposed SAS highlights the importance of timely involvement of component auditors during various phases of the audit.</p>									
Yes	CLA	<p>We found the organization and structure of the proposed SAS to be helpful and support the placement of the subsections relating to the component auditor and referred-to auditor.</p>									

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Yes	COV	We support the placement of sub-sections throughout the proposed SAS that highlight the requirements when component auditors are involved or when reference is made to the audit of a referred-to auditor in the auditor's report on the group financial statements.	
Yes	Crowe	Yes. We find that both the subsections for specific requirements when component auditors are involved and the separate paragraphs in the standard for requirements when referred-to auditors are involved are an effective way to convey those requirements.	
Yes	Deloitte	Yes. D&T is supportive of the placement of sub-sections throughout the standard and believes it enhances the clarity of the applicability of requirements and application material.	
Yes	Eide Bailly	The placement of the sub-sections is helpful and simplifies when an auditor is looking for guidance when component auditors or referred-to- auditors are involved in group audits. These sub-headings in conjunction with Exhibit A which highlights the required paragraphs will be helpful when auditors are trying to determine the requirements in various scenarios. We support the placement of these sub-sections throughout the proposed SAS.	
Yes	EY	Yes, we support the placement of subsections throughout the proposed SAS that highlight the requirements when component auditors are involved.	
Yes	ICPAS	Yes.	
Yes	Mazars	Yes, we support the placement of sub-sections throughout the proposed SAS.	
Yes	MI OAG	We support the placement of sub-sections throughout the SAS that highlight the requirements when component auditors are involved or when reference is made to a referred-to auditor. Such placement allows for efficient research on topics without referring to another AU-C section.	
Yes	NSAA	We support the placement of subsections throughout the proposed SAS that highlight the requirements when component auditors are involved or when reference is made to the audit of a referred-to auditor in the auditor's report on the group financial statements.	
Yes	OSCPA	Section headings and exhibits added clarity on when the sections were applicable.	
Yes	PwC	<p>Yes, the sub-sections in each section of the standard clearly set out considerations for the group engagement team when component auditors are to be involved in the group audit. These sub-sections are helpful when navigating the standard and provide clarity over which requirements apply in a given engagement's circumstances.</p> <p>These sub-sections also aid the scalability of the standard and may be particularly helpful to smaller group audit engagements performed entirely by the group engagement team (for example, if the group entities are all audited by the same team from a single office).</p>	
Yes	RSM	We support the placement of sub-sections throughout the proposed SAS that highlight the requirements when component auditors are involved, or when reference is made to the audit of a referred-to auditor in the auditor's report on the group financial statements. We believe the proposed structure will be very helpful as it will enable an auditor to quickly identify and differentiate the requirements for the particular situation.	
Yes	SL	Yes, the structure and placement of the sub-sections are reasonable throughout the proposed SAS. It follows the path of the current AU-C in terms of AU-C numbers, making sections easy to navigate as readers follow through the regular AU-C with this proposed SAS as an enhancement.	
Yes	TIC	Yes, the placement of these sub-sections is supported by TIC.	

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Yes	TXCPA	The PSC supports the placement of subsections in the proposed SAS that emphasize the requirements when component auditors are involved and the references made regarding a referred-to auditor in a group audit.	
Yes	VSCPA	The Committee supports the placement of the sub-sections throughout the proposed SAS as this benefits auditors of group audits.	
3. Is the scope and applicability of the proposed SAS clear? In that regard, is the definition of group financial statements, including the linkage to a consolidation process, clear?			
Definition of GFS is clear	Deloitte	Yes. D&T believes the scope and applicability of the proposed SAS, as well as the definition of group financial statements, is clear.	
Definition of GFS is clear	GAO	We support the definition of group financial statements, including the linkage to a consolidation process.	
Definition of GFS is clear	GT	[We] believe the definition of group financial statements is reasonably clear.	
Definition of GFS is clear	Mazars	Yes, the scope and applicability of the proposed SAS, including the definition of group financial statements is clear.	
Definition of GFS is clear	PwC	We also support the intent of the change in definition of group financial statements and the linkage to a consolidation process.	
Definition of GFS is clear	RSM	We also believe the definition of group financial statements, including the linkage to a consolidation process, is generally clear.	
Definition of GFS is clear	TIC	The definition of group financial statements [is clear], including the linkage to a consolidation process.	
Definition of GFS is clear	TXCPA	The definition of group financial statements and the linkage to a consolidation process are clear in the proposed SAS.	
Definition of GFS is unclear	BDO	We find the linkage between the definition of the “group financial statements” and “consolidation process” could be ambiguous under certain fact patterns that are common in practice. The application guidance in paragraphs A4 and A5 attempts to distinguish between two scenarios involving a single legal entity, where one involves the aggregation of financial information while the other doesn’t. Many legal entities are capable of maintaining discrete financial information associated with separate locations, branches, divisions, or product lines within a single general ledger system. For example, a retail entity may be capable of maintaining discrete financial information by individual store locations. The process of aggregating the financial information associated with retail store locations in this example is different from aggregating financial information prepared by one or more branches or divisions of a group that maintain separate information systems and general ledgers. We recommend providing further clarity in the application material regarding the concept of “aggregation” of financial information of entities that is relevant to the definition of group financial statements and the term <i>consolidation process</i> used in the proposed SAS to avoid any unintended consequences, including inconsistent application in practice.	
Definition of GFS is unclear	CLA	We recommend the ASB provide more application guidance or other materials (e.g., a flowchart or decision tree) to help auditors with determining whether an engagement includes group financial statements, which is therefore subject to the scope of the proposed SAS.	
Definition of GFS is unclear	COV	We noted that the clarified SAS removes the link of a group financial statement and components, which broadens the business units that could qualify for group financial statements. Specifically, paragraph	

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		<p>A4 states “a single legal entity may be organized with more than one business unit ... when those business units have characteristics such as separate locations, separate management, or separate information systems.” We believe the inclusion of “or” within the guidance is improper in a government environment as many business units have separate locations and separate management that are aggregated into a single legal entity’s financial statements; and, in many cases, we would not expect those to create a group audit scenario.</p> <p>To align with the audit requirements for components throughout the proposed SAS, we conceptually believe it is more logical to define a group as components aggregated through a consolidation process. To assist the auditor in identifying components (or business units) that trigger the group audit requirements, the Board should further clarify the relevant criteria for assessing the extent to which separate locations, management, and information systems represent components (or business units) of a group. The following are questions the Board may consider in providing this guidance:</p> <ul style="list-style-type: none"> • Location: Does the mere physical presence of the business unit within a separate building constitute a different location? Does the proximity of the business unit location to the group have any effect on the assessment (i.e., street address, campus, town, county, state, country)? • Management: In a government environment, authority may be delegated to various levels of management. For example, in producing an Annual Comprehensive Financial Report (ACFR), a Governor may delegate responsibility to an agency to produce the ACFR by aggregating financial information from other agencies. As it relates to aggregated Executive branch agencies, is the Governor and his or her administration considered management, or should consideration also be given to differences in agency-level management? • Information Systems: Does the significance of information systems to the financial statements (i.e., the general ledger) affect the assessment of the group? For example, if a business unit uses the same general ledger system as the group, but uses its own capital assets system, does the number of separate systems or materiality of financial amounts within the capital assets system affect the auditor’s assessment? 	
Definition of GFS is unclear	Eide Bailly	<p>The definition of the group financial statements provides helpful information in conjunction with the application and explanatory material. However, we have the following thoughts related to paragraphs A29-A31 and the consolidation process.</p> <p>We believe this is an area that creates some confusion in practice and additional examples would be helpful. As a suggestion, should there be a more detailed example perhaps expanding the financial institution example which is already introduced in paragraph A4. This paragraph discusses operating in separate locations with multiple branches and how the separate characteristics, such as separate management or separate information systems (including a separate general ledger) are aggregated and how such financial statements meet the definition of group financial statements. Should this same financial institution example be expanded within paragraph A31 by demonstrating if a bank has a holding company or other legal entity combined with the financial institution that is required to be consolidated? This may demonstrate the difference between aggregation risk considerations for an entity with multiple branches verses the aggregation risk considerations of consolidations. Another</p>	

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		<p>common occurrence is when management, controls, processes, and information systems are the same for a group of consolidated entities. Consequently, some groups of consolidated entities may have less aggregation risk than others, which could significantly impact component materiality evaluations and audit approaches. Expanding A31 could provide needed practice guidance in applying the standard to varying risk considerations. This would be particularly helpful as paragraph A7 appears to indicate that an engagement team could reach a conclusion that there's no aggregation risk in a consolidation when legally separate entities are under same management, controls, and information systems, etc.</p> <p>For considerations specific to Government Entities, paragraph 3 of the Exposure Draft references the AICPA Audit and Accounting Guide for <i>State and Local Governments</i> which is a non-authoritative guide. We believe it would be beneficial to expand the application and explanatory material with specific examples for Government entities as opposed to referencing a non-authoritative guide. A common simple example that could be added is when a component unit is blended into a reporting unit. Another very common example is when the aggregate remaining reporting unit includes a number of unrelated activities under the same management, controls, process, and information systems and contrasting when there are disaggregated elements of the reporting unit.</p>	
Definition of GFS is unclear	NSAA	<p>However, with respect to the definition of group financial statements, specifically the linkage to a consolidation process, we ask the board to clarify the guidance in paragraph A4. Currently, this paragraph indicates the mere existence of multiple locations, separate management, or separate information systems for which financial data is consolidated meets the definition of group financial statements. Particularly in the case of larger governments, there may be cases of a single entity with multiple locations, hierarchical structures of government with delegated management authority, and cases where the general ledger system may be the same but a particular financial system, such as capital asset management software, may be different. In such scenarios, treatment as a group audit may not be appropriate. We ask the board to consider limiting the definition of a group audit to the consolidation element rather than the multiple business unit approach.</p>	
Definition of GFS is unclear	OSCPA	<p>The committee appreciates the principles-based determination of a group financial statement that is highlighted in A4 for situations in which a single legal entity's financial statement could be deemed a group financial statement. The considerations noted in A4 and A5 used in making this determination, including having separate locations, separate management and separate information systems, the committee found as reasonable. We questioned, however, whether those same considerations could be used to conclude that a consolidated financial statement would not be a group financial statement; for example, if the separate legal entities have similar locations, management, and information systems. The definition of group financial statements in paragraph 16 appears to require that all consolidations would be within the group audit scope, however the committee feels there are situations in which closely held entities which legally may be consolidations, do not encompass the same risks and features that the group audit standards are intended to address.</p> <p>The committee recommends that in addition to the examples in A4 and A5, a third example be provided to support and illustrate that the principles-based guidance can also be used to exclude a consolidated entity from being a group financial statement.</p>	

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Definition of GFS is unclear	VSCPA	The Committee believes the scope and applicability of the proposed SAS lacks clarity when detailing business units that comprise the group financial statements. We believe the proposed standard would benefit from additional clarity on what constitutes a business unit.	
Scope and applicability are clear	CLA	We found the scope and applicability of the proposed SAS to be clear.	
Scope and applicability are clear	Crowe	We believe the scope and applicability of the proposed SAS is clear. Further, the application guidance will be helpful to auditors when making the significant judgment of identifying the components in a group audit.	
Scope and applicability are clear	Deloitte	Yes. D&T believes the scope and applicability of the proposed SAS...is clear.	
Scope and applicability are clear	Eide Bailly	Yes, we believe that the scope and applicability of the proposed SAS provides more clarity about the scope compared to the extant standards.	
Scope and applicability are clear	EY	We support the approach to the scope and applicability of the proposed SAS except as it relates to investments accounted for by the equity method. See our response to Question 9 for further comments.	
Scope and applicability are clear	GAO	The scope and applicability of the proposed SAS are clear.	
Scope and applicability are clear	GT	We do not have significant concerns with the scope and applicability of the proposed SAS.	
Scope and applicability are clear	ICPAS	Yes, we believe the scope and applicability of the proposed SAS is clear.	
Scope and applicability are clear	Mazars	Yes, the scope and applicability of the proposed SAS, including the definition of group financial statements is clear.	
Scope and applicability are clear	NSAA	We believe the scope and applicability of the proposed SAS are clear.	
Scope and applicability are clear	PwC	Scope and applicability are clear. We appreciate that the proposed SAS gives further guidance on how to consider shared service centers when planning and performing a group audit, as these structures are becoming ever more integral to record-keeping and financial reporting, and as a result, are of increasing importance to an auditor's understanding of the group's system of internal control.	
Scope and applicability are clear	RSM	We believe the scope and applicability of the proposed SAS is generally clear.	

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Scope and applicability are clear	TIC	Yes, it's TIC's position that the scope and applicability of the proposed SAS is clear.	
Scope and applicability are clear	TXCPA	The scope and applicability of the proposed SAS...are clear in the proposed SAS.	
Scope and applicability are unclear	COV	We believe that the scope and applicability of the proposed SAS lacks clarity when detailing business units that comprise the group financial statements.	
Scope and applicability are unclear	MI OAG	We suggest the Board consider going beyond paragraph 3's reference to the Audit and Accounting Guide for State and Local Governments and add a section of "Considerations Specific to Governmental Entities", similar to other AU-C sections. These considerations would address group audits of governmental component units.	
Scope and applicability are unclear	SL	It is mostly clear, but there is still some ambiguity in regard to smaller, less complex entities that have different entities established for risk mitigation or through prior acquisitions. Some of these entities are structured to have a single or overall accounting department with the same system of internal control and, while certain portions of the operations are maintained separately, the financial information is not presented as disaggregated for external reporting purposes (particularly paragraph A127 in AU-C section 320 and the reference to what is defined as financial information that is disaggregated, as either internal only, or externally presented). Question 9 We appreciate the statement that component performance materiality does not need to be an arithmetical calculation based on materiality.	
Scope and applicability are unclear	VSCPA	The Committee believes the scope and applicability of the proposed SAS lacks clarity when detailing business units that comprise the group financial statements. We believe the proposed standard would benefit from additional clarity on what constitutes a business unit.	
4a . Do you believe the proposed SAS is scalable to groups of different sizes and complexities, recognizing that group financial statements, as defined in the proposed SAS, include the financial information of more than one entity or business unit? If not, what suggestions do you have for improving the scalability of the proposed SAS?			
No	COV	We believe that the scalability of the proposed SAS is dependent on clarifying the definition of a business unit, as mentioned in the response for Request for Comment 3. If separate locations, management, or information systems independently qualify as individual business units without application of professional judgement, implementation may be inefficient in a government environment.	
No	Eide Bailly	Scalability is a more challenging concept to apply in group audits than in other standards. In other standards, scalability is an opportunity to adapt to less complex environments. In this standard, the primary requirements are identifying the components, assessing aggregation risks, and developing responses to those risks. Accordingly, it's difficult to apply scalability considerations to these requirements. The most helpful guidance regarding potential scalability, as noted in our responses above regarding paragraphs A4, A7, and A31, is to develop application guidance that helps auditors determine when consolidations and certain other activities are not considered a group audit and/or do not have material aggregation risks. Additionally, upon determining that the audit is of a group financial	

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		statement, if there are opportunities to scale based on different sizes and complexities of group audits, the application guidance should provide more robust illustrations of such considerations.	
No	VSCPA	The Committee believes the scalability of the proposed SAS is dependent upon clarification of the definition of a business unit as mentioned in comment 3.	
No	SL	The proposed SAS is somewhat scalable to groups of different sizes and complexities. Possibly more examples of entities with less complexity where group audit procedures may be limited or reduced.	
Yes, with suggestions	BDO	<p>The proposed SAS is generally scalable to groups of different sizes and complexities and provides for increased flexibility and alignment with the principles of a risk-based audit approach in planning and performing a group audit.</p> <p>While the proposed SAS is adaptable to a wide variety of circumstances, it does present additional practical challenges for the group engagement partner seeking to comply with the responsibilities in the proposed QM SAS with respect to determining compliance of component auditors with the relevant ethical requirements and the sufficiency and appropriateness of engagement resources, particularly on larger and more complex group audits that require extensive involvement of component auditors. These challenges are heightened in circumstances involving component auditors that are not part of the same network as the group auditor.</p>	
Yes, with suggestions	GT	<p>We found the proposed requirements to be reasonably scalable in terms of execution of risk assessment and further audit procedures. We have some practical concerns with regard to certain of the requirements specifically designated for execution by the group engagement partner, as described in proposed paragraph 13. Refer to our feedback to Question 7 below.</p> <p>We also believe the proposed standard could be enhanced by providing additional application material with regard to how the auditor may use a completed audit of a component for purposes of the group audit. We encourage the Board to add application material to proposed paragraph 32a to explain that understanding the group may include understanding applicable statutory audit requirements of components and the timing of such audits. We believe this information can help inform (1) the group auditor's consideration of where risks of material misstatement may arise within components and (2) the appropriate response to such risks. See also our response to Question 9 below.</p> <p>We also believe that certain clarifications to proposed paragraph A144 will enhance the scalability and understandability of the guidance provided. We submit the following edits for the Board's consideration.</p> <p style="padding-left: 40px;">In response to the assessed risks of material misstatement, the group auditor may determine the following scope of work to be appropriate at a component (with the involvement of component auditors, as applicable):</p> <p style="padding-left: 80px;">Design and perform further audit procedures on the entire financial information of the component <u>(for example, when a component auditor is asked to perform an audit, adapted as necessary, of the component financial information for purposes of the group audit)</u></p>	

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		<p style="text-align: center;">Design and perform further audit procedures on one or more classes of transactions, account balances, or disclosures</p> <p style="text-align: center;">Perform specific further audit procedures <i>designed by the group auditor</i></p> <p>We also recommend adding an example similar to the first bullet above to proposed paragraph A120.</p> <p>Finally, in considering the existing requirements of AU-C section 300, we believe it is most appropriate to limit “key members of the engagement team” to the individuals that meet the definition of “group auditor” as defined in the proposed SAS. We believe that there could be unintended consequences of including component auditors as key engagement team members. As such, we recommend revising proposed paragraph A64 as shown below. We believe this edit clearly delineates what the group auditor is ultimately responsible for while also acknowledging that the component auditor can contribute to planning activities.</p> <p style="text-align: center;">AU-C section 300 requires the engagement partner and other key members of the engagement team to be involved in planning the audit. When component auditors are involved, one or more individuals from a component auditor may <i>assist</i> be key members of the engagement team and therefore involved in planning the group audit.</p> <p>Such changes would also address the potential inconsistency in definitions and requirements between the proposed SAS and AU-C section 300. Paragraph .05 of AU-C section 300 requires the engagement partner and other key members of the engagement team to be involved in planning the audit, including planning and participating in the discussion among engagement team members. Planning an audit, as described in paragraph .02 of AU-C section 300, involves establishing the overall audit strategy and audit plan. The definition of group auditor, however, recognizes that the group auditor, which excludes component auditors, is responsible for establishing the overall group audit strategy and group audit plan. Including component auditors as key engagement team members can potentially blur a firm’s responsibilities for the group audit opinion and also challenge whether the independence requirements would differ for such individuals, particularly when such individuals are outside the firm’s network.</p>	
Yes, with suggestions	ICPAS	<p>We believe that the proposed SAS is scalable to groups of different sizes and complexities. However, when applying the risk-based approach prescribed in the proposed SAS, if the group audit firm differs from the component audit firm, use of different audit methodologies may present an issue. We see this as a challenge in terms of scalability of the standard, particularly in instances where there is a sub-consolidation performed by the component auditor. We would like to see more guidance or tools on how the use of different audit methodologies by the component auditors is addressed by the group auditor, such as instances where testing approaches differ (i.e., sample sizes utilized for both tests of controls and tests of details).</p>	
Yes, with suggestions	Mazars	<p>Yes, we believe that the emphasis on an auditor’s professional judgement makes the proposed standard scalable to different sizes and complexities of groups. However, we are concerned that the lack of guidance on how to determine the extent of work to be performed on components will lead to diversity in practice. We recommend that the development of implementation guidance be considered related to scoping by component.</p>	

Overall Opinion	Commenter	Comment	Response to Comment
Yes, with suggestions	NSAA	Our only concern is related to the scalability to larger governments per our response to question three.	
Yes, with suggestions	OSCPA	The committee agreed that the proposal is scalable in principle, but would like more examples and implementation materials regarding the application of concepts to varying circumstances.	
Yes, with suggestions	PwC	<p data-bbox="516 326 638 350"><i>Scalability</i></p> <p data-bbox="516 386 1713 475">While we generally believe the proposed SAS is scalable to groups of different sizes and complexities, further guidance is necessary in a number of areas to promote more consistent application of the principles-based requirements in the proposed SAS.</p> <p data-bbox="516 511 1724 716">It is important that the proposed SAS supports auditors in being able to scope and plan the audit based on the nature and circumstances of the group, and recognizes the important roles both group and component auditors play in contributing to group audit quality. In this regard, it is important that, in moving away from some well-recognized concepts in extant AU-C section 600 (e.g., significant components), the ASB is satisfied that the proposed SAS continues to support high-quality group audits, including consistent judgments about scoping of the group audit and the nature, timing, and extent of the involvement of component auditors.</p> <p data-bbox="516 751 1724 1146">For example, extant AU-C section 600 established specific requirements when a significant component is identified by the group engagement team, which is defined as a component that (i) is of individual financial significance to the group, or (ii) due to its specific nature or circumstances, is likely to include significant risks of material misstatement of the group financial statements. While we appreciate that the proposed SAS is aimed at promoting a risk-based approach rather than a quantitative exercise, we are concerned that the important principles underpinning these extant requirements are not given sufficient prominence, which could impact quality. We suggest changes to the application material to reinforce auditor judgments made in applying the requirements in paragraphs 24 and 39 of the proposed SAS. We believe certain concepts contained in the PCAOB's standards could be incorporated to drive further consistency in the US in terms of these judgments about how best to address risks of material misstatement in the group financial statements. We also believe further examples as to when specific further audit procedures may be used would be helpful. See paragraphs A59 and A145 in Appendix 2</p> <p data-bbox="516 1182 926 1206"><i>Review of component auditor work</i></p> <p data-bbox="516 1242 1724 1412">Also with regard to question 4a, we note the new requirement in paragraph 49 for the group auditor to determine whether, and the extent to which, it is necessary to review additional component auditor documentation. We believe it is important that the group auditor be able to exercise professional judgment in relation to the nature, timing, and extent of review of the work of component auditors, taking into account the two-way communication that has occurred throughout the audit. In many cases, the group auditor may not consider it necessary to obtain and review audit documentation beyond what</p>	

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		is required to be provided by, and discussed with, the component auditor in accordance with paragraphs 47-48 of the proposed SAS.	
Yes	CLA	We believe the principles-based approach makes the application of the requirements in the proposed SAS more scalable. The clarification of the roles and responsibilities of the engagement partner combined with the removal of prescribed approaches to significant components provides flexibility to respond appropriately to identified risks and improves efficiencies in group audits.	
Yes	Crowe	We believe the proposed SAS reflects a principles-based approach designed to allow auditors to focus on the risks of material misstatement in the group financial statements while appropriately considering and addressing aggregation risk.	
Yes	Deloitte	Yes. D&T acknowledges the ASB’s commitment to including scalability within the proposed SAS and believes the proposed SAS is capable of being applied to the audits of entities with a wide range of sizes, complexities, and circumstances.	
Yes	EY	We believe the proposed SAS is scalable.	
Yes	GAO	We believe the proposed SAS is scalable to groups of different sizes and complexities.	
Yes	MI OAG	Yes, we believe the proposed SAS is scalable between large and small governments.	
Yes	RSM	We believe the proposed SAS is scalable to groups of different sizes and complexities. We note that the standard properly focuses on identifying, assessing and responding to the risks of material misstatement using a principles-based approach that is adaptable to a wide variety of circumstances and scalable for audits of groups of different complexity. This allows the group auditor to determine an appropriate approach to obtaining sufficient appropriate audit evidence to address assessed risks of material misstatement of the group financial statements.	
Yes	TIC	Yes, the proposed SAS is scalable to groups of different sizes and complexities.	
Yes	TXCPA	The PSC believes that the proposed SAS is scalable to audit groups of various sizes and complexities.	
4b. Do you believe that the guidance in exhibit A, “Relevancy of Requirements in Various Group Audit Scenarios,” of the proposed SAS is understandable and provides clarity on the relevancy of certain requirements of the proposed SAS in various group audit scenarios? Would the relevancy of certain requirements of the proposed SAS in various group audit scenarios be clear without exhibit A?			
Clear, Necessary (with suggestions)	CLA	We found exhibit A of the proposed SAS to be useful. We suggest the AICPA provide additional guidance to help firms with the implementation of the proposed SAS for each of the scenarios in exhibit A.	
Clear, Necessary (with suggestions)	NSAA	Broadly, we believe Exhibit A to be understandable and that it provides clarity on the relevancy of certain requirements of the proposed SAS in various group audit scenarios. This exhibit should remain in the final standard and it is helpful to have this material in one location, particularly given that some requirements are common across scenarios. One suggestion for improved clarity would be the reconsideration of including paragraph 36 as a relevant requirement for Scenarios 1 and 3. The titles for Scenarios 1 and 3 may lead users to conclude that no component auditors are involved which would make the inclusion of paragraph 36 confusing.	

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Clear, Necessary (with suggestions)	OSCPA	The committee found exhibit A to be very helpful for clarity in the applicability of sections of the draft, and suggests that exhibit A be put in the front of the draft instead of in the appendix (“start here”).	
Clear, Necessary	BDO	We found exhibit A to be understandable and demonstrative of the scalability in the proposed SAS, particularly for less complex group audits, where the group auditor does not involve component auditors and/or does not make reference to the audit of a referred-to auditor.	
Clear, Necessary	COV	The guidance in exhibit A is very helpfully and it should remain within the proposed SAS.	
Clear, Necessary	Eide Bailly	We believe that the guidance in Exhibit A, “Relevancy of Requirements in Various Group Audit Scenarios” is understandable and provides clarity on the relevance of certain requirements of the proposed SAS in various group audit scenarios. We don’t believe Exhibit A should be removed, as without Exhibit A there could be more variances in practice in determining the application of the standards within various scenarios.	
Clear, Necessary	GAO	The guidance in exhibit A is understandable and provides needed clarity on the relevancy of certain requirements of the proposed SAS in various group audit scenarios, and it should be retained.	
Clear, Necessary	ICPAS	We believe while the proposed SAS in various group audit scenarios is clear without exhibit A, exhibit A is understandable and provides a useful reference point for practitioners to identify the relevant requirements for their respective fact patterns.	
Clear, Necessary	Mazars	Yes, the guidance in exhibit A is understandable and provides clarity on the relevancy of certain requirements of the proposed SAS in the group audit scenarios presented. Given the consistent identification of which proposed SAS paragraphs relate to both component auditor and referred-to auditor scenarios, the relevancy of such requirement would be clear without exhibit A. However, we believe that the inclusion of exhibit A is a useful guide for practitioners.	
Clear, Necessary	MI OAG	Yes, we consider exhibit A as straightforward and understandable and have no suggested edits. While readers should be able to interpret the provisions of the proposed SAS without exhibit A, we think the exhibit provides clarity to apply the standards consistently among the various scenarios and it should remain in the final standard.	
Clear, Necessary	RSM	We believe the guidance in Exhibit A, “Relevancy of Requirements in Various Group Audit Scenarios,” of the proposed SAS is understandable and provides clarity. We believe the relevancy of the requirements of the proposed SAS in various group audit scenarios would be clear without Exhibit A; however, Exhibit A provides a very helpful reference.	
Clear, Necessary	SL	Exhibit A is very helpful and the proposed SAS would not be clear without Exhibit A.	
Clear, Necessary	TIC	Yes, the guidance in exhibit A is understandable and provides clarity on the relevancy of certain requirements of the proposed SAS in various group audit scenarios. TIC supports the retention of exhibit A.	
Clear, Necessary	VSCPA	Exhibit A is helpful and should remain within the proposed SAS.	
Clear, Unnecessary	Crowe	We do not believe that exhibit A is necessary for auditors to understand the requirements of the proposed SAS, including the requirements when utilizing referred-to auditors. However, we have no	

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		objection to the inclusion of the exhibit, as it may be helpful for auditors to validate that their audit plan will comply with the relevant requirements in the proposed SAS.	
Unclear, Necessary	GT	<p>We found Exhibit A very helpful and encourage the Board to retain it with the final standard. While we believe that auditors would be able to determine the relevancy of requirements, this exhibit leaves little margin for doubt and is an efficient approach to navigating the requirements.</p> <p>That said, there are a few items on which we request clarification. First, it is unclear why each scenario begins with paragraph 12 of the proposed standard when the requirements section does not begin until paragraph 18. We believe it is the Board’s intention to only address the requirements section of the proposed standard and, therefore, recommend revising each scenario to begin with paragraph 18.</p> <p>Additionally, for Scenarios 1 and 3, we note that paragraph 36 is included as a relevant requirement. However, paragraph 36 is under the heading “Considerations When Component Auditors Are Involved.” We believe proposed paragraph 36 is not intended to apply only when component auditors are involved. We recommend deleting the heading and revising the paragraph as follows.</p> <p style="padding-left: 40px;">In applying AU-C section 315, the group auditor should evaluate whether the audit evidence obtained from the risk assessment procedures performed by the group auditor, and component auditors <i>when applicable</i>, provides an appropriate basis for the identification of assessment of the risks of material misstatement of the group financial statements.</p>	
Unclear, Necessary	PwC	Exhibit A is understandable and provides clarity to help auditors navigate the standard for circumstances applicable to their audits. This may need to be supplemented with additional guidance to support the auditor’s consideration of the nature, timing, and extent of direction, supervision, and review that may be necessary in relation to different types of group audits, including circumstances in which the group auditor and component auditor are not from the same network.	
Unclear, Necessary	TXCPA	Exhibit A provides vital guidance in implementing the proposed SAS and enhances clarity and understanding of the proposed requirements. It might be helpful to simplify exhibit A to include scenarios that do not have multiple complex issues in a single example.	
Unclear, Unnecessary	KPMG	<p>The relevancy of certain requirements in the proposed SAS in various group audit scenarios is sufficiently clear without exhibit A because of the placement of sub-sections throughout the proposed SAS that highlight such requirements. Despite the introductory paragraphs in exhibit A reminding group auditors that they are “required to have an understanding of the entire text of this proposed SAS, including its application and other explanatory material, to understand its objectives and apply its requirements properly”, we have concerns over implementation in practice. Specifically, the content in exhibit A may be misinterpreted as if only the requirements presented in tabular format in exhibit A are applicable in various group audit scenarios, which could lead to misapplication of the proposed SAS and a negative impact to audit quality.</p> <p>If the Board determines exhibit A should be retained in the final SAS, and as we understand exhibits to be authoritative in nature, we offer the following recommendation for the Board’s consideration to further enhance clarity of exhibit A. We note that the relevant requirements in tabular format begin with paragraph 12 of the proposed SAS. We recommend the Board to include references to paragraphs 1-</p>	

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		11 as applicable for completeness, or further clarify why the relevant requirements included in exhibit A begin with paragraph 12 (when requirements in the proposed SAS start with paragraph 18).	
5. Do you support the enhanced requirements and application material on documentation, including the linkage to the requirements of AU-C section 230?			
Yes	BDO	We support and agree with the enhancements to the documentation requirements.	
Yes	CLA	We support the enhanced requirements and application material on documentation.	
Yes	COV	We support the enhanced requirements and application material on documentation, include the linkage to the requirements of AU-C section 230.	
Yes	Crowe	We believe the documentation requirements in the proposed SAS, when considered along with the requirements of AU-C section 230, are appropriate and complete.	
Yes	Deloitte	Yes. D&T is supportive of the enhanced requirements and application material on documentation.	
Yes	Eide Bailly	We support the enhanced requirements and application materials on documentation and the linkage to the requirements of AU-C Section 230.	
Yes	EY	We support the enhanced requirements and application material on documentation in the proposed SAS.	
Yes	GAO	We support the enhanced requirements and application materials on documentation.	
Yes	GT	We support the enhanced documentation requirements and application material, including the linkage to existing requirements of AU-C section 230.	
Yes	ICPAS	We support the enhanced documentation requirements as presented in paragraph 76 of the proposed SAS.	
Yes	Mazars	Yes, we support the enhanced requirements and application material on documentation, including the linkage to the requirements of AU-C section 230.	
Yes	OSCPA	The committee found the documentation requirements very consistent with current practices and did not identify any omitted documentation requirements.	
Yes	PwC	We do not have concerns about the enhanced requirements and application material on documentation.	
Yes	RSM	We support the enhanced requirements on documentation, including the linkage to the requirements of AU-C section 230.	
Yes	TIC	TIC supports the enhanced requirements and documentation materials.	
Yes	TXCPA	The PSC supports the enhanced requirements of documentation, including linkage to the requirements of AU-C section 230. The PSC did not note any significant changes from current practice. The linkage to SQMS is critical due to emphasis on risk-based audit processes. The PSC also thought that if documentation was restricted, the result would be hesitancy to utilize component auditors.	
Yes	VSCPA	The Committee supports the enhanced requirements and application material on documentation.	
5a . Are there specific matters that you believe should be documented other than those described in paragraph 76 of the proposed SAS?			
Additions	CLA	The ASB should consider requiring documentation of the requirements in 59.c ii relating to appropriateness of conversion entries.	
Additions	Crowe	Paragraph 76.i. requires documentation of “The group auditor’s evaluation of, and response to, <i>findings or conclusions</i> of the component auditors or referred-to auditors about matters that could have a material effect on the group financial statements.” We are unsure how this requirement is distinguished from 76.g.ii. and 76.h.iii, which require documentation of matters related to communications with component auditors and referred-to auditors, respectively, “including how the group auditor has	

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		addressed <i>significant matters</i> discussed with” component auditors and referred-to auditors, respectively. Specific to referred-to auditors, we believe that 76.i. is in part alluding to evaluating their issued auditor’s report, and whether it includes any opinion modifications or other report modifications that may be relevant to the group auditor (consistent with the requirements in paragraph 61). If that is the intent in the proposed SAS, we recommend that this be clarified by adding application guidance for paragraph 76.i.	
Additions	Eide Bailly	We believe that the specific matters identified in paragraph 76 are sufficient and relevant. However, one area that we believe can be expanded within the application material is related to the documentation requirement when the same firm conducts the audit of the component and is the group auditor. In practice, it may be common where one office/team within the same firm will conduct the audit of the component and another team/office will be the group auditor. Paragraph A74 provides some guidance related to the determination of a component auditor’s competency and capability. Paragraph A91 states that the form of communication would be affected when the group auditor and component auditor are from the same firm. Paragraph 76 states that the group auditor should include in the audit documentation all of the components noted in paragraph 76, such as competence and capability (par. 76c), the direction and supervision of the component auditors and review of their work (par. 76f). As noted in paragraphs A74, the firm’s monitoring procedures and communication is relied on in these two examples. The firm has its own monitoring procedures to identify competency and has procedures for documenting evidence of review and has various levels of review. The extent of the documentation required by the group auditor in this example when the same firm conducts the audit of the component and is the group auditor would be an example where we suggest additional application guidance would be beneficial, specifically related to competency of the auditor, direction, supervision, and review of the component auditor’s work within the same firm but different locations and teams. The application material should include whether it is expected that all of these elements are explicitly documented in the binder or is it sufficient to know that the firm’s monitoring procedures cover the requirement related to competency, supervision, and review of the component auditor within the same firm.	
Additions	ICPAS	We suggest additional discussion of risks and uncertainties that may be present at the component auditor level, including, but not limited to 1) local regulatory, 2) litigation, and 3) cyber related matters.	
Ok as is	GAO	We did not identify any additional matters that should be documented outside of those described in paragraph 76.	
Ok as is	GT	We did not identify any additional matters that we believe should be included in proposed paragraph 76. We found the application material helpful in considering how the documentation requirements may be scalable in different group audit scenarios.	
Ok as is	Mazars	There are no matters that we believe should be documented other than those described in paragraph 76 of the proposed SAS.	
Ok as is	MI OAG	No, there are no other specific matters that should be documented.	
Ok as is	NSAA	We do not believe there are any additional specific matters to be documented.	
Ok as is	PwC	We did not identify any additional matters that we believe should be documented.	
Ok as is	RSM	There are no specific matters that we believe should be documented other than those described in paragraph 76 of the proposed SAS.	
Ok as is	SL	We are not aware of additional specific matters that should be documented.	
Ok as is	TIC	None of significance were noted by TIC.	

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5b. Do you agree with the application material in paragraphs A203–A219 of the proposed SAS relating to the group auditor’s audit documentation?			
No	GT	Paragraph A205 of the proposed SAS indicates that audit documentation comprises not only the documentation in the group auditor’s file but also the separate documentation in the respective component auditor files relating to the work performed by the component auditors for purposes of the group audit. While we conceptually understand the purpose of this statement, we are concerned with the potential ramifications from an audit quality as well as an inspection and regulatory perspective, particularly with respect to jurisdictions with confidentiality or professional secrecy restrictions. We encourage the Board to consider additional guidance or requirements, taking into account PCAOB standards, addressing audit documentation that would be retained in the group audit file to meet the objectives of AU-C section 230 and that would be sufficient from an external inspection perspective.	
No	OSCPA	Additional guidance would be beneficial regarding assessing component materiality.	
Yes, with suggestions	CLA	We agree with the application material in paragraphs A203-A219 in the proposed SAS. However, we have some concerns about the requirements for the final assembly and retention of a component auditor’s documentation. When the retention of component auditor documentation is outside the control of the group auditor, we believe it would be difficult for a firm to design and implement responses to address quality risks relating to the quality objective in proposed SQMS No. 1 paragraph .32f. We suggest the ASB consider enhancing the guidance in A206 of the proposed SAS to indicate that providing specific instructions to the component auditor would normally be a sufficient response to such quality risks.	
Yes, with suggestions	ICPAS	We agree with the application material in paragraphs A203–A219 of the proposed SAS, however, we suggest including reference to the sufficiency of procedures performed by the component auditor in direct response to the identified group-level assessed risks of material misstatement. By removing the requirement to identify significant components, with more targeted risk-based procedures performed at the component audit level, there is added importance on ensuring sufficient procedures have been performed on overall risks of material misstatements assessed at the group level and relevant to the component auditor.	
Yes	BDO	[We support and agree with the] related application material in the proposed SAS.	
Yes	COV	We support the enhanced requirements and application material.	
Yes	Crowe	The application guidance is comprehensive and will help auditors to evaluate the sufficiency and clarity of their documentation related to the group audit.	
Yes	Deloitte	Yes. D&T is supportive of the enhanced requirements and application material on documentation.	
Yes	Eide Bailly	We support the enhanced requirements and application materials on documentation and the linkage to the requirements of AU-C Section 230.	
Yes	GAO	We agree that the information in paragraphs A203–A219 is helpful application material.	
Yes	Mazars	Yes, we agree with the application material in paragraphs A203-A219 of the proposed SAS relating to the group auditor’s audit documentation.	
Yes	MI OAG	We agree with the application material and offer no suggested edits.	
Yes	NSAA	We agree with the application material.	
Yes	RSM	We support the enhanced requirements on documentation, including the linkage to the requirements of AU-C section 230 and the application material in paragraph A203–A219.	
Yes	SL	Yes, we agree with the application material.	
Yes	TIC	Yes, TIC agrees with this application material.	

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Yes	TXCPA	Even though documentation requirements are more extensive in the proposed SAS, they are necessary. Adequate summarization of work performed by the component auditor should be required in a group audit. However, it is not necessary to obtain all documentation of work performed by the component auditor unless required to do so by separate and applicable regulations. The PSC did not note any requirements contrary to existing standards, but rather a more defined and expanded documentation requirement.	
Yes	VSCPA	The Committee supports the enhanced requirements and application material on documentation.	
6. Are the definitions of the terms referred-to auditor, component auditor, and group auditor clear, including as they relate to the definition of the term engagement team in the proposed QM SAS?			
All definitions are clear, with suggestions	Crowe	<p>We find the definitions clear and understand the need to exclude the referred-to auditor from the engagement team.</p> <p>Related to the definition of component, we note that the extant standard provides the following: “An entity or business activity for which group or component management prepares financial information that is required by the applicable financial reporting framework to be included in the group financial statements.” We believe that the preparation of financial information is a key element of the identification of a component. We recommend the ASB re-insert such language in the definition of component in the proposed SAS.</p>	
All definitions are clear	BDO	We find the definitions of these terms to be sufficiently clear, including in the context of the term engagement team in the proposed QM SAS.	
All definitions are clear	CLA	We believe the terms defined in the proposed SAS are clear, especially as they relate to auditors of governmental entities.	
All definitions are clear	Deloitte	Yes. D&T believes the definitions are clear, including as they relate to the definition of the term “engagement team.”	
All definitions are clear	Eide Bailly	The definitions provided in paragraph 16 related to component auditor and group auditor are clear. The definition of the term for referred-to auditor seems to provide more clarity than the extant standards and differentiates it from being a component auditor which is helpful to auditors in understanding the difference.	
All definitions are clear	EY	Yes, we believe definitions are clear and would help auditors understand the differences, which aren’t clear in extant AU-C section 600.	
All definitions are clear	GAO	The definitions of the terms referred-to auditor, component auditor, and group auditor are clear, including as they relate to the definition of “engagement team” in the proposed SQMS.	
All definitions are clear	GT	We support the new terms and believe the related definitions are sufficiently clear. We believe that separating referred-to auditors from component auditors will enable auditors to better understand and navigate the requirements in different group audit scenarios.	
All definitions are clear	KPMG	The definitions of the terms <i>referred-to auditor</i> , <i>component auditor</i> , and <i>group auditor</i> , within the context of the proposed SAS, are clear.	
All definitions are clear	Mazars	Yes. the definitions of the terms referred-to auditor, component auditor, and group auditor are clear in the proposed standard, including how they relate to the definition of “engagement team” per Statement on Auditing Standard No. 146, Quality Management for an Engagement Conducted in Accordance with Generally Accepted Auditing Standards.	

Agenda Item 3A – Group Audits, Comment Letter Summary

Overall Opinion	Commenter	Comment	Response to Comment
All definitions are clear	OSCPA	The committee felt that the definitions provide greater clarity, particularly on what qualifies as a group audit.	
All definitions are clear	RSM	We believe the definitions of the terms referred-to auditor, component auditor and group auditor are clear, including as they relate to the definition of the term engagement team in the proposed QM SAS.	
All definitions are clear	TIC	Yes, TIC believes these definitions are clear and is supportive of these definitions along with the necessary clarifications they provide as related to the engagement team responsibility.	
All definitions are clear	TXCPA	The definitions of referred-to, component and group auditor were clear. It appears that the main difference between a referred-to auditor and component auditor is that the referred-to auditor is not part of the engagement team, whereas a component auditor is part of the engagement team. It is also possible for an audit firm to serve as a referred-to auditor and a component auditor. In this case, materiality of work performed to overall audit report should be the differentiating factor.	
All definitions are clear	VSCPA	The Committee believes the definitions of the terms “component auditor” and “group engagement partner” as they relate to the definition of “engagement team” are clear.	
Definition of CA is unclear	COV	We believe there is opportunity to clarify the definition of the terms “component auditor” and “group engagement partner” as it relates to the definition of the term “engagement team.” Paragraph A23 provides that component auditors may be from a group auditor’s firm. Paragraph A28 indicates that there may be joint engagement partners within a group auditor’s firm, but does not define the term “joint engagement partner.” When a group and its components are audited by different audit teams within the same firm and each audit team is supervised by a partner (or partner equivalent) under the same firmwide system of quality control, we are unclear on whether the partner responsible for auditing a component is a joint engagement partner or a component auditor.	
Definition of CA is unclear	ICPAS	The term “group engagement team” has been replaced with the term “group auditor,” and the component auditor is not included as part of the “group auditor.” We believe more clarification is warranted in order to distinguish the “group auditor” and “component auditor” within the context of the “engagement team” and to clearly delineate that the “referred-to auditor” as being outside of the “engagement team.” (Application Material A19; A23). Perhaps a diagram or flowchart would be helpful in distinguishing these concepts.	
Definition of CA is unclear	John Keyser	Paragraph 16’s definition of component does not specifically mention that an equity method investee is considered to be a component. Although this is clarified in the definition of group financial statements , the Board should consider explicitly including equity method investees in the definition of component .	
Definition of CA is unclear	NSAA MI OAG	We believe the SAS should include a definition of “joint engagement partner” which is referenced in paragraph A28. In group audits where different components are audited by separate audit teams within the same firm under the direction of separate partners or partner equivalents we are unclear as to whether these partners are “joint engagement partners” or “component auditors.”	
Definition of CA is unclear	PwC	As described in our response to question 1, we believe that uncertainty remains as to the practical implications of the change in SAS 146 to include component auditors within the definition of engagement team. One example of this is the effect on compliance with independence and ethical requirements.	
Definition of CA is unclear	SL	Regarding the consideration of component auditor, there is still some ambiguity similar to the extant standards for smaller firms that do not use other offices, affiliates or other firms to perform audits, excluding specific procedures (such as, inventory observations), and use their own team members that	

Overall Opinion	Commenter	Comment	Response to Comment
		<p>are the same as the group engagement team (now group auditor). The smaller firms may also use another outside or network firm to audit a subsidiary, but in most cases, the group auditor performs both the role of the group auditor and component auditor at the same time. We would ask for another category or scalable considerations to the situation where the group auditor and component auditor are one and the same.</p> <p>In Paragraph 7. A recommendation is to clarify the use of component auditors outside the group engagement team, or make the last sentence refer to involvement of component auditors outside the group engagement team. While the results of the engagement could be the same, additional documentation would be needed to clarify the use of component auditors, when the teams are the same, and would expand documentation to ensure all component auditor sections documentation is performed and recorded.</p>	
Definition of GA is unclear	COV	<p>We are concerned with the wording from paragraphs 16 and A85 that, “the group auditor is responsible for directing and supervising the component auditors and review of their work.” We believe clarification should be added to identify what would constitute as directing and supervising the component auditors and reviewing their work. For example, when auditing the ACFR, does this imply the engagement partner must directly supervise and review all state audits? We feel this is not practical or efficient when other engagement partners are already supervising and reviewing those projects under the same firmwide system of quality control.</p>	
Definition of GA is unclear	NSAA MI OAG	<p>We are concerned with the language of paragraph 16 and A85 which states, “the group auditor is responsible for directing and supervising the component auditors and review of their work.”</p> <p>Specifically, in the case of a group audit of a state’s ACFR performed by the same firm, does this guidance require that the engagement partner directly supervise all component auditors within the same firm? This is not efficient and is impractical given the engagement partner and component auditors will be operating under the same firmwide system of quality control.</p> <p>We recommend broadening the definition of group auditor found in paragraph 16 to read (insertions italicized):</p> <p><i>The firm comprised of the group engagement partner and members of the engagement team, including those component auditors who are within that same firm and follow the same system of quality control as the group engagement partner. The group auditor excludes all other than component auditors.</i></p> <p>If this change is made, additional edits would be needed for paragraph A23 (insertions italicized with strikeouts).</p> <p>References in this proposed SAS to the engagement team, <i>as defined in QM SAS paragraph 12</i>, include the group auditor and component auditors. Component auditors may be from a network firm, a firm that is not a network firm, or the <i>same firm as the group engagement partner auditor’s firm</i> (for example, another office within the group auditor’s firm). <i>In the latter case, consideration as to whether the component auditors are part of the group auditor will depend on whether that component audit’s</i></p>	

Overall Opinion	Commenter	Comment	Response to Comment
		<p><i>engagement team is under the same system of quality control as the group engagement partner.</i></p> <p>If these changes are considered, then the guidance in paragraphs 27 and 28 would need to be updated to include a reference to the group auditor, as appropriate.</p>	
Definition of RTA is unclear	ICPAS	Although we noted the definitions of referred to auditor and component auditor in paragraph 16 (Definitions), we questioned the purpose of introducing the concept of the “referred-to auditor” and how it differs from the idea of a component auditor, especially since the proposed SAS says it is equivalent to the component auditor.	
7. Is the requirement in paragraph 11 clear? (11. The engagement partner should review the overall audit strategy and audit plan.)			
Yes	BDO	Yes, we believe the conforming amendments to paragraph 11 in AU-C section 300 are sufficiently clear.	
Yes	CLA	We believe the requirements in paragraph 11 are clear.	
Yes	COV	We believe the requirement is clear.	
Yes	Crowe	We believe the proposed addition of paragraph 11 in AU-C section 300, <i>Planning an Audit</i> , is appropriate related to engagement partner responsibility. Overall, we find that the requirements in other AU-C sections combined with the requirements for the group engagement partner in the proposed SAS are sufficiently clear and appropriate.	
Yes	Deloitte	Yes.	
Yes	Eide Bailly	The requirement as written in paragraph 11 of Appendix C is clear as written.	
Yes	EY	We agree with the ASB that professional skepticism is important and support the emphasis in the proposed SAS. Paragraph 11 clearly states the requirement for the engagement team, including the group auditor, to plan and perform the group audit with professional skepticism and exercise professional judgment.	
Yes	GAO	The requirement in paragraph 11 is clear.	
Yes	ICPAS	Yes.	
Yes	Mazars	Yes, the requirements related to professional skepticism are clear and sufficient.	
Yes	MI OAG	We consider paragraph 11 and the associated application material as clear.	
Yes	NSAA	Yes, the requirements are clear.	
Yes	OSCPA	The committee found the requirements for engagement partner responsibility to be clear.	
Yes	PwC	Yes, the proposed changes to the requirement in paragraph 11 of AU-C section 300 related to the engagement partner’s review of the overall strategy and audit plan is clear. We note the effect of this change (which was approved by the ASB in finalizing SAS 146) is to extend the requirement in paragraph 19 of extant AU-C section 600 in relation to the group audit strategy and group audit plan to all audits (not just group audits).	
Yes	RSM	We believe the addition of paragraph 11 to AU-C Section 300, Planning an Audit, clarifies the group engagement partner’s responsibility to review the overall audit strategy and audit plan.	
Yes	SL	Yes, the requirement is clear.	
Yes	TIC	Yes, TIC believes this requirement is clear and reasonable as the ultimate responsibility for the engagement lies with the engagement partner.	
Yes	TXCPA	The requirement in paragraph 11 of the proposed SAS is clear. The engagement partner should design the overall audit plan and strategy and retain overall responsibility for the audit.	

Overall Opinion	Commenter	Comment	Response to Comment
Yes	VSCPA	The Committee believes the requirement in paragraph is clear.	
7. Are there additional requirements or application material relating to paragraph 11 that are needed, and if so, what should they be? (Par. 11 of AU-C 300. The engagement partner should review the overall audit strategy and audit plan.)			
Additions	CLA	We recommend the ASB consider adding “local business practices” to paragraph A17, first bullet.	
Additions	GT	We support the inclusion of a proposed requirement in order to enhance audit quality and emphasize the overall responsibility of the engagement partner (in a group audit or otherwise). However, we believe application material is necessary to address potential operational challenges, particularly in terms of group audits. In AU-C section 300, the audit plan includes, among other things, the nature, timing, and extent of further audit procedures. In large group audits, it may be impractical for the group engagement partner to directly review, without assistance from others, all details of a group audit plan. We encourage the Board to add application guidance to convey the requirement’s intended purpose and its practical application more clearly, particularly in group audits.	
Ok as is	COV	There are no additional requirements or application material that are needed related to paragraph 11.	
Ok as is	Deloitte	D&T believes the requirement in paragraph 11 is clear without additional requirements or application material.	
Ok as is	Eide Bailly	We do not have additional requests specific to this requirement.	
Ok as is	GAO	There are no additional requirements or application material needed relating to paragraph 11.	
Ok as is	ICPAS	We believe no additional requirements are needed.	
Ok as is	MI OAG	No additional guidance is necessary.	
Ok as is	NSAA	We do not believe additional requirements or application material are needed.	
Ok as is	PwC	We do not believe additional requirements or application material related to paragraph 11 are necessary. However, the ASB should consider whether additional guidance is needed if questions arise during exposure in relation to how this requirement would be implemented for all audits (e.g., in relation to how detailed the overall strategy and audit plan needs to be and how technology may be used to facilitate the development and review of the overall strategy and plan).	
Ok as is	RSM	We are not aware of the need for any additional requirements or application material relating to paragraph 11.	
Ok as is	VSCPA	There are no additional requirements or application material relating to paragraph 11 that are needed at this time.	
8. Do you agree with the deletion of this requirement and the related application paragraph? (Paragraph 14b of extant AU-C section 930, <i>Interim Financial Information</i>, is deleted. Paragraph 14b includes a reference to significant components and requires the auditor, when conducting a review of interim financial information, to obtain reports from component auditors, if any, related to reviews performed of the interim financial information of significant components of the reporting entity, including its investees, or inquire of those auditors if reports have not been issued)			
No	Crowe	Related to the proposed edit to delete paragraph 14b and related application paragraph A17 of AU-C section 930, <i>Interim Financial Information</i> , we understand the need to modify 14b because it includes the term “significant components”, which are no longer required to be identified in the proposed SAS. We note that the content in A17 is “The auditor may find the guidance in section 600, <i>Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)</i> , useful in conducting a review of interim financial information for an entity that prepares group financial statements.” We find this content to be relevant and meaningful even with the changes in the proposed	

Overall Opinion	Commenter	Comment	Response to Comment
		<p>SAS.</p> <p>Accordingly, we recommend that A17 be retained in AU-C section 930 and included with another paragraph in the standard, if 14b is deleted. Alternatively, paragraph 14b could be modified, rather than deleted, to remove the reference to significant components and the requirement to obtain a report.</p>	
No	GT	<p>We understand the Board's basis for proposing to delete paragraph 14b of AU-C section 930; however, we note that the Board has retained an illustrative report example making reference to a referred-to auditor's review report. We are concerned that retaining the illustrative report example while deleting paragraph 14b and its related application material could lead to confusion. We ask the Board to instead (1) revise 14b to require obtaining the referred-to auditor's review report when the auditor plans to make reference to a referred-to auditor's review report in the auditor's review report on the group interim financial statements and (2) reinstate the application material that guides the auditor to consider AU-C section 600 in such circumstances.</p>	
No	ICPAS	<p>We suggest modifying this paragraph instead of deletion of guidance altogether. Though the concept of significant components will be eliminated, we believe obtaining interim review reports on relevant elements of the reporting entity, if deemed appropriate by the group auditor to support their interim review procedures, remains an important procedure when performing the review of interim financial information under AU-C section 930.</p>	
Yes	CLA	<p>We agree with removing this requirement based on the changes in the proposed SAS and suggest relying on knowledge obtained from the audit to scope review procedures.</p>	
Yes	BDO	<p>We are supportive of eliminating the concept of "significant components" from the proposed SAS. While the requirements and related application material associated with identifying significant components provides a more structured approach to scoping a group audit, the requirements and related application guidance dictate the scope of work to be performed at a component level based on a top-level categorization of components. As the size and complexity of a group increases, for example, when the group financial statements are disaggregated across a large number of smaller components, the application of the approach described in the extant standards become increasingly challenging. We believe the proposed SAS more closely aligns with the overarching principles and objectives of conducting a risk-based audit, by focusing the group auditor's attention on determining the nature, timing and extent of audit procedures necessary at the individual component level to identify, assess and respond to risks of material misstatement of the group financial statements.</p> <p>We agree with the proposed conforming amendments to delete paragraph 14b and the related application paragraph A17 of AU-C section 930, <i>Interim Financial Information</i>. We believe this requirement in AU-C section 930 is unnecessary and should be based on the auditor's professional judgment depending on the facts and circumstances of the review engagement.</p>	
Yes	COV	<p>We agree with the deletion of the requirement and related application paragraph.</p>	
Yes	Deloitte	<p>Yes. D&T agrees with the deletion of such requirement and related application paragraph.</p>	
Yes	Eide Bailly	<p>We agree with the deletion of the removal of "significant components" and shifting this assessment to a risk-based approach which aligns more closely with auditing standards; however, it does leave more interpretation and judgement to auditors in determining an appropriate approach to obtain sufficient audit evidence and adequately address risk of material misstatement at the group</p>	

Agenda Item 3A – Group Audits, Comment Letter Summary

Overall Opinion	Commenter	Comment	Response to Comment
		financial statement level. The removal of paragraph 14b of AU-C Section 930, <i>Interim Financial Information</i> , which requires the auditor to obtain reports from component auditors, if any, related to reviews performed of the interim financial information of significant components should not have that much of an impact since the group auditor is still responsible for obtaining information about components throughout the audit.	
Yes	EY	We agree with the deletion of this requirement and the related application paragraph.	
Yes	GAO	We agree with the deletion of the concept of “significant components” requirement and related application paragraph.	
Yes	Mazars	Yes, we agree with the deletion of the requirement in paragraph 14b. of AU-C section 930, <i>Interim Financial Information</i> (“AU-C 930”) and the related application paragraph. We do not believe that the deletion of such information changes the intent of the guidance in AU-C 930.	
Yes	MI OAG	We agree with the deletion of the concept of “significant components”.	
Yes	NSAA	We agree with the deletion.	
Yes	OSCPA	We agree with deleting the requirement in .14b to “obtain reports from component auditors related to reviews performed of the interim financial information of significant components of the reporting entity,” as there are no “significant components” under the proposed standard.	
Yes	PwC	Yes, we support deletion of the requirement and related application material in AU-C section 930, which required the auditor to obtain reports from component auditors, if any, related to reviews performed of the interim financial information of significant components of the reporting entity. In practice, we believe auditors would look to the proposed SAS and make appropriate requests for component auditors to be involved in an interim review if necessary to do so.	
Yes	RSM	We agree with the deletion of the requirement for the group auditor to identify and audit significant components as we believe this deletion further allows the proposed SAS to be scalable. The elimination of the concept of “significant components” supports the proposed standard’s focus on identifying, assessing and responding to the risks of material misstatement using a principles-based approach that is adaptable to a wide variety of circumstances and scalable for audits of groups of different complexity.	
Yes	SL	Yes, we agree with the deletion of this requirement as it relates to interim reviews.	
Yes	TIC	Yes, TIC agrees with the deletion of this requirement and the related application paragraph. In a private company environment, it’s not as common to have components subject to interim financial information.	
Yes	TXCPA	The PSC does not have an objection to the removal of the concept of “significant components.”	
Yes	VSCPA	The Committee agrees with the deletion of the requirement and related application paragraph.	
8. Do you have other suggestions for considering components in interim reviews now that the concept of “significant components” has been eliminated?			
Ok as is	CLA	Because these engagements are not common in our practice, we have no additional suggestions.	
Ok as is	COV	We do not have any additional suggestions for considering components in interim reviews.	
Ok as is	Deloitte	D&T is supportive of the proposed amendments to AU-C section 930, <i>Interim Financial Information</i> , without additional revisions.	
Ok as is	GAO	We have no other suggestions.	
Ok as is	MI OAG	no suggestions regarding the application of interim reviews.	
Ok as is	NSAA	[We] have no suggestions for considering components in interim reviews.	
Ok as is	VSCPA	We do not have any other suggestions for considering components in interim reviews at this time.	

Overall Opinion	Commenter	Comment	Response to Comment
Suggestions	EY	<p>We suggest that the ASB add a requirement under paragraph 14c for auditors conducting a review of interim financial information to make the following additional inquiry of management:</p> <p><i>xiii. whether component auditors engaged to review interim financial statements of components, if any, communicated any material modifications that should be made to interim financial statements for them to be in accordance with the applicable financial reporting framework.</i></p> <p>The application paragraph in extant AU-C 600 would still be appropriate to support this requirement.</p>	
Suggestions	OSCPA	The proposal should still provide the option to obtain such reports if based on the risk assessment, it is deemed necessary to do so for a particular component.	
Suggestions	TXCPA	The reason for the elimination is not clear. Consideration of materiality of a component should be considered when exercising a risk-based approach to the audit.	
9. Do you agree with the application material in paragraphs A47–A49 of the proposed SAS relating to a noncontrolling interest in an entity that is accounted for by the equity method?			
No	CLA	We agree with the application material in paragraphs A47 – A48 of the proposed SAS. However, we believe paragraph A49 should be removed as the guidance relates to accounting standards and is unnecessary in the context of a group audit standard.	
No	Crowe	<p>It is our understanding that an auditor should only be following the guidance in paragraph A48 if the group financial statements include a noncontrolling interest in an entity that is accounted for by the equity method investment (which reflects a risk of material misstatement to the group financial statements) and the group auditor’s access to information or people at the entity is restricted. This would preclude the group auditor being able to audit the equity method investment themselves or through the involvement of a component auditor.</p> <p>We note that A48 indicates that the group auditor may be able to use “audited financial statements” as audit evidence. We are concerned that a group auditor may interpret this that, even if they do not have specific access restrictions at the entity, they can directly apply A48 and obtain audited financial statements for the equity method investment and “take credit” for the substantive audit work performed on the equity method investment, without any interactions with the auditor of the equity method investment.</p>	
No	Eide Bailly	The application material in paragraphs A47-A49 is clear. However, paragraph A49 suggests that restrictions on access to information or people of the equity method entity is an indicator that challenges management’s assertion on accounting for the investment under the equity method. Current accounting guidance regarding equity method investments does not address restricted access in determining the extent of influence. Is it the intent of the standard to introduce additional considerations in determining the application of accounting standards? We recommend that A49 be removed or be updated to more clearly connect an auditor’s evaluation of management’s assertion of the extent of influence in applying the accounting standards.	

Overall Opinion	Commenter	Comment	Response to Comment
No	EY	<p>Though we agree with the application material regarding access restrictions, we believe the proposed guidance does not sufficiently address the common situation of group management and the group auditor not having sufficient access to component management, those charged with governance of the component, or the component auditor. Specifically, when the group has a non-controlling interest in an entity that is accounted for by the equity method, the group auditor is often not able to establish an arrangement with the investee auditor or investee management under which the group engagement team would direct the activities of the investee auditor and review its audit documentation.</p> <p>We recommend that the ASB consider aligning the SAS with the PCAOB’s approach. We believe the PCAOB’s amendments offer a practical framework to design and execute a quality audit when investee auditors are involved. Additionally, having consistent US auditing standards would eliminate unnecessary complexity and inconsistencies in practice.</p> <p>We are concerned that differences between this proposed SAS and the PCAOB’s amendments relating to the <i>Supervision and Audits Involving Other Auditors</i> would create unnecessary complexity and inconsistencies in practice. Under the PCAOB’s amendments, the auditor reporting on an EMI would not always be considered a component auditor, and the results of that auditor’s procedures would fall under the scope of PCAOB Auditing Standard (AS) 1105, <i>Audit Evidence</i>.</p> <p>We agree with and support the PCAOB’s approach in this matter (see section VII. Other Matters in Appendix 4 of PCAOB Release No. 2022-002), specifically that the group auditor should not be required to direct and supervise the work of the investee auditor in executing its audit separate from the group audit, and thus, it is possible that the investee auditor would not be considered a component auditor (i.e., not part of the engagement team). This approach would address situations in which the group auditor is unable to direct the activities of an investee auditor, as described above.</p> <p>Further, we support the PCAOB’s amendments, which allow a group auditor to use the work and report of the investee’s auditor in situations in which the valuation of an investment is based on the investee’s financial results by evaluating the sufficiency and appropriateness of audit evidence. We believe this principles-based approach will enable the group auditor to exercise professional judgment to scale its procedures to the facts and circumstances of the audit.</p> <p>We recommend that the ASB converge its final standard with that of the PCAOB with respect to investee auditors, given the potential for diversity in practice.</p>	
No	KPMG	<p>Investments accounted for using the equity method (that is, EMIs) are considered components and the requirement for the group auditor to exercise the same level of direction, supervision, and review of the component auditor of an EMI as the component auditor of a consolidated entity has always been, and</p>	

Overall Opinion	Commenter	Comment	Response to Comment
		<p>continues to be, a challenging area in practice on group audit engagements. This applies under both the extant AU-C section 600 and the proposed SAS. While paragraphs A47-A49 and A10 are helpful, we do not believe they fully resolve the implementation challenges as it relates to the group auditor’s responsibilities over component auditors of EMIs. While there is conceptual merit to treating the EMI as a component, the practical reality is that group management generally has less power, influence, and oversight over the EMI, particularly when compared to a consolidated entity. As a result, the same challenges extend to the group audit engagement, where the group auditor has less inherent ability to direct and oversee the component auditor of the EMI. These practical challenges exist under extant AU-C section 600 and will continue under the proposed SAS.</p> <p>One example may be where the component audit of the EMI is already completed prior to the start of the group audit. In this case, the group auditor likely has no ability to direct or oversee the component auditor’s work over the financial statements of the EMI that is already completed, and yet as stated in paragraph A10, “in any event, the requirements of this proposed SAS apply, including those relating to the direction and supervision of component auditors and the review of their work”.</p> <p>We note that this issue was deliberated as part of the PCAOB’s standard-setting project, <i>Supervision of Audits Involving Other Auditors</i>. We observe that “under the proposed amendments in the PCAOB’s 2016 proposal and the 2017 Supplemental Request for Comment, the investor’s auditor in such equity method investment situations would have been in the position of a lead auditor [under PCAOB standards], and thus required to supervise the work of the investee’s auditors in accordance with AS 1201” (i.e. the group auditor would be required to exercise the same level of direction and supervision over the component auditor of an EMI as the component auditor of a consolidated entity, consistent with extant AU-C 600 and proposed SAS). However, as discussed in the PCAOB’s 2021 Second Supplemental Request for Comment (2021 SSRC) 2, the PCAOB acknowledged that it has received comments that “the investor’s auditor may not be able to establish an arrangement with the investee’s auditor or investee management under which the investor’s auditor would direct activities of the investee’s auditor and review its audit documentation or obtain information from investee management”.</p> <p>After considering the comments received, the PCAOB stated in the 2021 SSRC that they are “no longer proposing to require that the investor’s auditor supervise the investee’s auditor’s work under AS 1201, for example, in equity method investment situations”. “Instead, in such situations, the investor’s auditor would look to the requirement of Appendix B of the evidence standard (AS 1105), which describe the auditor’s responsibilities for obtaining sufficient appropriate evidence in situations in which the valuation of an investment is based on the investee’s financial results.” The 2021 SSRC includes proposed amendments to AS 1105 Appendix B paragraph B1 which states: “Financial statements of the investee that have been audited by an auditor (“investee’s auditor”) whose report is satisfactory, for this purpose, to the investor’s auditor may constitute sufficient appropriate evidence.” The 2021 SSRC proposed further amendments that “the [investor’s] 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</p>	

Overall Opinion	Commenter	Comment	Response to Comment
		and the results thereof, and reviewing the audit program and/or working papers of the investee's auditor".	
No	PwC	<p>We believe the application material in paragraph A10 of the proposed SAS relating to circumstances in which the auditor intends to use work already performed on component financial statements for purposes of the group audit is helpful, as is the specific application material in paragraphs A47-A49 relating to a noncontrolling interest in an entity that is accounted for by the equity method when access is restricted.</p> <p>We believe, however, that there may be merit in being more clear that the guidance in paragraphs A47-A49 may be more widely applicable and suggesting an alternative approach to obtaining audit evidence in relation to equity method investees.</p>	
Yes	BDO	We are in agreement with application material.	
Yes	COV	We agree with the application material in paragraphs A47-A49 relating to a noncontrolling interest in an entity that is accounted for by the equity method.	
Yes	Deloitte	Yes. D&T agrees with the application material in paragraphs A47–A49 and, in particular, supports the application material in A48 that audited financial statements, including financial statements audited by a referred-to auditor, may be used as audit evidence relating to a noncontrolling interest in an entity that is accounted for by the equity method.	
Yes	GAO	We agree with the application material in paragraphs A47–A49 of the proposed SAS relating to a noncontrolling interest in an entity that is accounted for by the equity method.	
Yes	Mazars	Yes, we agree with the application material relating to a noncontrolling interest in an entity that is accounted for by the equity method and believe it is sufficient.	
Yes	MI OAG	We agree with the application material in paragraphs A47-A49 and offer no suggested edits.	
Yes	NSAA	We agree with the application material in paragraphs A47 - A49 relating to a noncontrolling interest in an entity accounted for by the equity method.	
Yes	RSM	We agree with the application material in paragraphs A47–A49 of the proposed SAS relating to a noncontrolling interest in an entity that is accounted for by the equity method.	
Yes	SL	Yes, we agree with the application material in paragraphs A47 to A49.	
Yes	TIC	Yes, TIC agrees with the application material. TIC noted it is consistent with the current approach and relatively simple to apply.	
Yes	TXCPA	The PSC generally agrees with the application material in paragraphs A47-A49 of the proposed SAS. The material adequately provides guidance on addressing difficulties obtaining financial information from a noncontrolling interest. The examples in the proposed guidance are also helpful.	
Yes	VSCPA	The Committee agrees with the application material in paragraphs A47-A49 of the proposed SAS relating to a noncontrolling interest in an entity accounted for by the equity method.	
9. Are there additional requirements or application material relating to EMIs that are needed in the proposed SAS, and if so, what should they be?			
Additions	COV	We believe there is an opportunity to include additional application material relating to EMIs that addresses additional suggested procedures if an EMI does not receive a separate audit, and therefore, no assurance can be placed on that audit.	
Additions	Crowe	We are also concerned that, despite the last paragraph of A48, a group auditor may believe that obtaining the audited financial statements for the equity method investment (when not using the investee's auditor as a referred-to auditor) is sufficient appropriate audit evidence to conclude on the	

Overall Opinion	Commenter	Comment	Response to Comment
		<p>financial information of the equity method investment included in the group financial statements. Without the performance of substantive audit procedures by the group auditor or interactions with the auditor of the equity method investment, we believe these procedures would only represent risk assessment procedures performed by the group auditor. The audit response for the equity method investment should be based on the group auditor’s risk assessment. For some equity method investments, risk assessment procedures alone may be an appropriate response for the group auditor but for other equity method investments, the group auditor will be required to perform further audit procedures. The discussion with A48 references “professional judgment”; however, we believe examples within the guidance to illustrate how differences in the risk assessment may impact the procedures performed by the group auditor would be helpful and contribute to more consistent performance by group auditors.</p>	
<p>Additions</p>	<p>EY</p>	<p>Additional application material relating to equity method investments (EMI) would be helpful to address practical challenges in applying ED-600 and proposed 600 SAS to EMIs.</p> <p>We believe that if the ASB decides to finalize its proposal, it would need to provide additional guidance to avoid diversity in practice. That is, we believe more guidance is needed to help auditors understand how to audit EMIs as components under the proposed SAS.</p> <p>We agree that an EMI has characteristics of a component, but we note that an entity accounts for an EMI differently than it accounts for a legal entity, branch or geography under consolidation accounting and makes different disclosures. Specifically, the financial position and results of an EMI are presented in the group financial statements in a note to the financial statements, and the only financial statement line items affected are investment in the EMI and equity in net income of the EMI. We believe this is a significant difference that would warrant different procedures from those performed for a component that is a legal entity, branch or geography. Notably, we believe the determination of planning materiality and scoping of significant accounts would be different for EMIs.</p> <p>To illustrate, consider a group audit that comprises 12 components, which include 10 consolidated legal entities and two EMIs. In the group financial statements, revenue would include the revenue of the 10 consolidated legal entities. Thus, a misstatement in the revenue of one component would represent a misstatement in the consolidated revenue of the group, but a misstatement in the revenue of one EMI would not affect the consolidated revenue of the group and would only affect the equity in net income account. We believe additional guidance could address diversity in practice regarding the following:</p> <ul style="list-style-type: none"> ▶ How the group auditor should consider risks of material misstatement in the underlying EMI financial statements ▶ How to identify significant accounts in an EMI component when the significant accounts are consolidated and presented as different significant accounts on the group financial statements 	

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		<p>(i.e., revenues and expenses of the EMI component are consolidated and presented as the equity in net income)</p> <p>► How to determine component materiality for a consolidated component and an EMI component</p> <p>Practical guidance on how to apply ED-600 to EMIs, specifically as it relates to the above matters, would help drive consistency in practice.</p>	
Additions	GT	<p>Auditing equity-method investments (EMIs) can introduce a unique set of challenges; we appreciate the Board’s proposed application guidance in this area. When we compared the extant application material to the proposed application material, we noted one concept that appears to be missing. Extant paragraph A23 discusses, in part, the following.</p> <p style="padding-left: 40px;">If the component is not a significant component and the group engagement team has a complete set of financial statements of the component, including the auditor’s report thereon, and has access to information kept by group management regarding that component, the group engagement team may conclude that this information constitutes sufficient appropriate audit evidence regarding that component.</p> <p>We acknowledge that the notion of “significant component” does not exist in the proposed SAS. However, we believe it would be beneficial to auditors if the proposed application material discusses the possibility that a complete set of financial statements of a component, including the auditor’s report thereon, may constitute sufficient appropriate audit evidence when the group auditor has access to information kept by group management regarding that component. We recommend incorporating this into the first bullet of proposed paragraph A48. Consideration may also be given to the PCAOB’s recently adopted standards and the definition of “investee auditor.”</p>	
Additions	KPMG	<p>Revising the proposed SAS and incorporating the relevant requirements for the investee auditor into AU-C 501.05, <i>Investments in Securities When Valuations are Based on Investee’s Financial Results</i>, similar to the PCAOB’s 2021 SSRC may be beneficial. The proposal outlined in the PCAOB’s 2021 SSRC strikes the right balance by defining “investee’s auditor” (i.e. component auditor over EMI) as a separate term and establishing a different level of group auditor requirements over the investee’s auditor. This approach recognizes the reality that EMIs are different from consolidated entities and thus the group auditor’s oversight of the audit of EMIs should be subject to differing requirements.</p> <p>We acknowledge that the guidance in paragraph A173 of the proposed SAS provides one potential solution, where the group auditor can make reference to the audit of the EMI as referred-to auditor in response to the practical challenges outlined above. However, the PCAOB’s 2021 SSRC also preserved the ability to make reference and we share the PCAOB’s view that separate requirements for the investee’s auditor are necessary in addition to the ability to make reference to referred-to auditor. We also acknowledge that our proposal for the Board to align with the PCAOB in this area would create</p>	

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		a divergence from the ISA 600 [Revised]. However, we believe the Board has an opportunity to make practical enhancements in this area that are necessary and in the public interest in the United States. Such enhancements will address the group auditor’s practical challenges related to direction, supervision, and review of component auditors of an EMI, and the ultimate improvement to audit execution and scalability will justify the divergence in this case.	
Additions	NSAA MI OAG	We request the board consider adding guidance that addresses situations where no assurance exists in cases where EMIs do not receive separate audits.	
Additions	PwC	In its Other Auditor project, we note that the PCAOB has decided to no longer require the investor’s auditor to supervise the investee’s auditor’s work in accordance with AS 1201. Appendix B of AS 1105, which was finalized in connection with the PCAOB’s Estimates project, provides helpful context in evaluating the relevance and reliability of audit evidence associated with the valuation of investments based on investee financial results. Other proposed amendments to AS 1105 clarify that the group auditor’s (lead auditor’s in PCAOB terminology) assessment of audit evidence associated with audited financial statements of equity method investees is not intended to classify the investee’s auditor as a component auditor (other auditor in PCAOB terminology).	
Additions	SL	In relation to EMI, there should be consideration of a separate concept of component performance materiality. For example, an EMI that is 30% owned by the group, should not have a component performance materiality of a comparative 100% owned component, as the risk of aggregated misstatements and risk of material misstatement represented by the 30% ownership is significantly less than another component of the same size. Expansion on determining component performance materiality for EMI would be helpful.	
Additions	TXCPA	The PSC would like to see additional guidance, such as a materiality threshold, on whether a failure to obtain information would be considered a scope limitation, to which the option to revert to cost basis is not appropriate.	
OK as is	BDO	[We] have no other comments relating to this section.	
OK as is	CLA	[We] do not believe additional requirements are needed.	
OK as is	GAO	There are no additional requirements or application material relating to Equity Method Investments that are needed in the proposed SAS.	
OK as is	OSCPA	The committee did not identify any additional requirements or desired guidance.	
OK as is	RSM	We are not aware of the need for any additional requirements or application material relating to equity method investments.	
OK as is	TIC	No additional requirements were surmised by TIC.	
10. Do you support retaining the option that exists in extant AU-C section 600 for the group engagement partner to make reference to the audit of a referred-to auditor (a component auditor per extant AU-C section 600) in the auditor’s report on the group financial statements?			
Yes	BDO	We are supportive of retaining the option that exists in extant AU-C section 600 to make reference to the audit of a referred-to auditor in the auditor’s report on the group financial statements. While the division of responsibility in the auditor’s report is relatively uncommon, such situations are necessary in practice. For example, the timing of a transaction entered into by a company (the group) may make it impracticable for the group auditor to assume responsibility for the work being performed by another auditor that is already in process or substantially complete. We find the introduction of the term referred-to auditor in the proposed SAS provides additional clarity with respect to the group auditor’s	

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		<p>performance obligations when using the work of a component auditor in contrast to situations where the group auditor plans to make reference to the audit of a referred-to auditor.</p> <p>The definition for the term referred-to auditor in the proposed SAS appears to be consistent with the PCAOB’s proposed amendments to its analogous standard (PCAOB Release No. 2021-005; Docket 042: Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard—Dividing Responsibility for the Audit with Another Accounting Firm, issued on September 28, 2021). The consistency in terminology between the AICPA and PCAOB standards supports the effective implementation of this change to firm methodologies, policies, tools, and technology.</p>	
Yes	CLA	We strongly support retaining the option for the group auditor to make reference to a referred-to auditor.	
Yes	COV	We support retaining the option that exists in extant AU-C section 600 for the group engagement partner to make reference to the audit of a referred-to auditor in the auditor’s report on the group financial statements and believe it is an important option to be included.	
Yes	Deloitte	Yes. D&T supports retaining the option that exists in extant AU-C section 600 for the group engagement partner to make reference to the audit of a referred-to auditor in the auditor’s report on the group financial statements and believes it is important for the AICPA to remain converged with the PCAOB on this topic.	
Yes	Eide Bailly	Yes, we support this as it makes it clear to the users of the financial statements who is responsible for the referred to audit.	
Yes	EY	We strongly support retaining the option that exists in extant AU-C section 600 for the group engagement partner to make reference to the audit of a referred-to auditor in the auditor’s report on the group financial statements.	
		Both the extant guidance and the proposed SAS provide a principles-based approach for the group engagement partner to take overall responsibility for managing and achieving quality on the group audit engagement. Additionally, removing the option would create a significant shift in practice, affecting preparers, auditors and others.	
Yes	GAO	We strongly support the option to allow the auditor to make reference to the audit of a referred-to auditor (a component auditor per extant AU-C section 600) in the auditor’s report on group financial statements. When an audit is performed in accordance with the requirements of this proposed SAS, referring to other auditors (divided responsibility) can improve audit efficiency for the group auditor without sacrificing effectiveness. It also preserves transparency by explaining in the group auditor’s report the portions of the audit performed by the referred-to auditor.	
		Although this represents a difference from international standards, we believe this difference is necessary. In some situations, the group auditor making reference to the audit of the referred-to auditor is the only option for completing the audit that is practical, feasible, or both. For example, a component of a government entity may be required by law or regulation to have its financial statements audited by auditors other than the group auditor, or management of the group may not have the authority to select the referred-to auditor. In such cases, making reference to the work of the referred-to auditor may be the best or only option available to the group auditor.	

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		Conversely, eliminating the option of divided responsibility would likely cause an increase in situations in which an auditor must qualify or disclaim an audit opinion, rather than having the option of reporting on the group financial statements and disclosing the division of responsibility among auditors. For example, the size, complexity, and diversity of the audit of the U.S. government's consolidated financial statements, in which withdrawal is not a viable option, make eliminating the option to make reference to a referred-to auditor problematic. The same situation holds true for large and complex state and local governments. For these reasons, we strongly believe that the option of referring to other auditors in the group auditor's report remains crucial.	
Yes	GT	We fully support retaining the option for the group auditor to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements. While we note it may not be frequently used in practice, it is a necessary and appropriate option for certain group audit scenarios.	
Yes	ICPAS	Yes.	
Yes	Mazars	Yes, we support retaining the option to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements.	
Yes	MI OAG	We strongly support retaining the option to make reference to the audit of a referred-to auditor per extant AU-C 600. We routinely elect this option and consider this option as essential in distributing the work-effort in a large governmental setting.	
Yes	NSAA	We support retaining the option that exists in extant AU-C section 600 for the group engagement partner to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements and believe it is important that it remains in the standard. In the government environment, it is normal to make reference to other auditors, especially in the case of discretely presented component units which often have statutory requirements to have a separate audit from the primary government. Removing this option would create hardship for our members.	
Yes	OSCPA	We agree with retaining the option to have referred-to auditors.	
Yes	PwC	Yes, we support retaining the option to make reference to the audit of a referred-to-auditor.	
Yes	RSM	We fully support retaining the option that exists in extant AU-C section 600 for the group engagement partner to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements.	
Yes	SL	Yes, we support retaining the option that exists for reference to another auditor, and the change to calling it referred-to auditor. This would be helpful for firms that have to use other firms that are not part of an association or network.	
Yes	TIC	Yes, TIC supports the option to make reference to the audit of a referred-to auditor.	
Yes	TXCPA	The PSC supports retaining the option in AU-C section 600 for the group engagement auditor to make reference to the audit of the referred-to auditor in the audit report.	
Yes	VSCPA	The Committee supports retaining the opinion that exists in extant AU-C section 600 for the group engagement partner to make reference to the audit of a referred-to-auditor in the auditor's report on the group financial statements.	

11. Are the specific requirements relating to referred-to auditors clear, appropriate, and easily identifiable within the proposed SAS, including when considering exhibit A?

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No	EY	<p>The requirements related to referred-to auditors are appropriate, but they are not easily identifiable within the proposed SAS. We struggled to identify the requirements that would apply when component auditors and referred-to auditors are involved without reliance on the exhibit.</p> <p>To enhance the readability and ease of use, the ASB should consider the following options:</p> <ul style="list-style-type: none"> • Issue a separate standard that includes the requirements and application material for circumstances when reference is made to the audit of a referred-to auditor in the auditor’s report on the group financial statements: The PCAOB took this approach in its proposal, since the referred-to auditor has a different level of supervision than a component team and is not part of the engagement team. • Present the requirements for circumstances when reference is made to the audit of a referred-to auditor in the auditor’s report on the group financial statements as a separate section within the SAS: Though this would create some repetition in the proposed standard (i.e., requirements that apply to both the involvement of component auditors and referred-to auditors), it would enhance the clarity of the requirements and application when using a referred-to-auditor. 	
No	PwC	<p>The requirements in the proposed SAS are intended to both leverage extant requirements and mirror the structure of the responsibilities of the group auditor in relation to component auditors. In our view, the requirements in the proposed SAS appear to be more restrictive than the requirements proposed by the PCAOB when dealing with referred-to auditors. For example, proposed PCAOB AS 1206 does not have a requirement to communicate significant risks to referred-to auditors, while the proposed SAS requires that the group auditor communicate significant risks that are relevant to the referred-to auditor. There may be practical challenges with this and other requirements (e.g., determining that referred-to auditors have the appropriate competence and capabilities) based on the level of access and communication the group engagement team is able to have with a referred-to auditor. Our view of the PCAOB’s proposed standard is that, while there are inquiries of, and representations from, the referred-to auditor, the expectation of the two-way dialogue between the group auditor and the referred-to auditor is substantially less than what would be anticipated between the group auditor and the component auditor.</p> <p>We question if the effort required by the proposed SAS is necessary for non-public companies audited under ASB standards as compared to public companies audited under PCAOB standards. Because the concept of referred-to auditors is unique to the US environment, we encourage the ASB to seek closer alignment with the PCAOB in setting its requirements, given the PCAOB’s plans to finalize its standard in the near future.</p> <p>Additionally, the construct of the standard has resulted in a level of repetition that might render it unclear. Clarifications to the wording and ordering of certain requirements would better follow the flow of the audit process and assist the auditor’s judgment in first deciding whether it is appropriate to make reference, and then how to do so. We also believe the ASB could seek to reduce the degree of duplication between a number of requirements, specifically in relation to independence and relevant</p>	

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		<p>ethical requirements. We offer some drafting suggestions in Appendix 2, but believe there may be further opportunities to streamline.</p> <p>Finally, we appreciate the focus in the requirements on the implications when the referred-to auditor has performed the audit in accordance with auditing standards other than GAAS or those of the PCAOB, as well as when the component's financial statements are prepared using a different financial reporting period from that used for the group financial statements. However, in terms of additional guidance, the ASB could consider elaborating on the audit implications when referring to another auditor in circumstances where the component financial statements are for a different financial reporting period than that of the group (as contemplated by paragraphs 42 and A113 of the proposed SAS).</p>	
Yes, with suggestions	Eide Bailly	<p>Yes, we do believe that the specified paragraphs 51-65 including Exhibit A provides sufficient clarity to auditors and are easily identifiable within the proposed SAS. Paragraphs 52 and 53 discuss competence and capabilities of referred -to auditors and the group engagement partners responsibility in relation to their competence and capabilities. Paragraphs A166-A168 in the application material provide additional guidance and indicate that judgement is involved. We believe that practitioners often rely on published peer review reports to make this conclusion. Considerations of competencies are outlined in paragraph A167. It is not uncommon for auditors to have favorable and unfavorable biases based on past experiences with other auditors. Such biases may not be appropriate generally, and more particularly on the specific audit being referred to. The first bullet of A168 is a self-certification from the referred-to auditor, which is meaningful evidence of their competency. We recommend that A167-A168 take the approach of evaluating the presentation and disclosure of the financial statements and identification of information in the component financial statements that contradicts audit evidence or accounting positions from the group financial statements as the other primary considerations of evaluating competences. Absent such errors and contradictions, group auditors often don't have sufficient evidence to evaluate competencies as currently outlined in the standard. Additionally, paragraph 52, as written, "When making reference to the audit of a referred-to auditor, the group engagement partner should take responsibility for determining that referred-to auditors have the appropriate competence and capabilities" seems to indicate that the group auditor is taking more responsibility than suggested in the application guidance. We recommend that this language be modified to clarify the responsibility. The following is a suggested modification, "When making reference to the audit of a referred-to auditor, the group engagement partner should take responsibility for use judgement to determine whether there is any contrary evidence that referred-to auditors have the appropriate competence and capabilities". As discussed above, contrary evidence would be material errors or omissions observed in the financial statements, contradictory information and evidence between the component and group financial statements, and deficiencies reported in the peer review report.</p> <p>If it is the intent of the Board for group auditors to have a substantial responsibility in determining that the referred-to auditor has the appropriate competency and capabilities, paragraph 52 should provide more definitive guidance on the types of evidence required to be obtained.</p>	

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Yes, with suggestions	GT	<p>We agree that the proposed requirements related to referred-to auditors are easily identifiable. Nevertheless, we propose certain revisions, as follows, to the requirements in order to enhance their clarity and understandability.</p> <ul style="list-style-type: none"> • We ask the Board to consider eliminating the lead-ins of proposed paragraphs 51, 52, and 54, since the auditor needs to execute on these requirements before making the decision to make reference to a referred-to auditor (such determination is addressed in proposed paragraph 55). We found the lead-ins confusing given the flow of the requirements. We believe that the headings and subheadings are sufficient to guide auditors to understand which requirements relate to making reference to referred-to auditors such that the lead-ins are unnecessary. • In order to enhance the understandability of the requirement, we recommend revising the first sub-bullet of proposed paragraph 51 as follows: <ul style="list-style-type: none"> a. Referred-to auditors having been made aware of <i>Communicating to referred-to auditors</i> <u>the</u> relevant ethical requirements that are applicable given the nature and circumstances of the group audit engagement <p>For consistency, we recommend a similar revision be made to the similar requirement for component auditors in proposed paragraph 27a.</p> <ul style="list-style-type: none"> • We noted that proposed paragraph 52 is in the context of the group engagement partner taking responsibility for determining that referred-to auditors have the appropriate competence and capabilities. However, proposed paragraph 28a, which relates to component auditors, is written as “the group engagement partner should determine...” It is unclear why the group engagement partner can assign responsibility for this action with regard to referred-to auditors but not component auditors. We ask the Board to reconsider these requirements and whether it would be more appropriate for them to be consistent. <p>We recommend flipping the order of bullets (a) and (b) of proposed paragraph 63 to align with the ordering in the corresponding requirements related to component auditors.</p>	
Yes, with suggestions	Mazars	<p>Yes, the specific requirements relating to referred-to auditors are clear, appropriate, and easily identifiable within the proposed SAS. However, we have concerns as to how the “communications with the referred-to auditor” (paragraphs 62 – 65) requirements will be applied in practice. Given the principles-based approach to the of extent of two-way communications between group auditors and referred-to auditors, and our historical experience when involved in engagements with referred-to auditors, we anticipate wide variation in the characteristics of certain two-way communications between group and referred-to auditors which could potentially have negative impacts on audit quality.</p>	
Yes	BDO	<p>We find the requirements in paragraphs 51-66 and the related application material relating to referred-to auditor to be sufficiently clear. We found exhibit A, “Relevancy of Requirements in Various group Audit Scenarios” to be helpful in providing examples of relevant requirements under different group audit scenarios.</p>	

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Yes	CLA	We believe the specific requirements relating to referred-to auditors are clear, appropriate, and easily identifiable within the proposed SAS without exhibit A. However, we believe exhibit A adds additional clarity by providing a concise reference for determining applicability in various scenarios.	
Yes	COV	We believe the specific requirements are clear, appropriate, and easily identifiable within the proposed SAS, including exhibit A.	
Yes	Deloitte	Yes. D&T believes the specific requirements relating to referred-to auditors are clear, appropriate, and easily identifiable within the proposed SAS.	
Yes	GAO	The specific requirements relating to referred-to auditors are clear, appropriate, and easily identifiable within the proposed SAS, including when considering exhibit A.	
Yes	MI OAG	Yes, we consider exhibit A as clear and appropriate in providing the necessary guidance for requirements regarding referred-to auditors.	
Yes	NSAA	We believe the specific requirements are clear, appropriate, and easily identifiable within the proposed SAS. Specifically, for Exhibit A, please see our response to question 4(b).	
Yes	OSCPA	Yes, except as indicated in the response to question 12 below.	
Yes	RSM	We believe the specific requirements relating to referred-to auditors are clear, appropriate and easily identifiable within the proposed SAS, including when considering Exhibit A.	
Yes	SL	Yes, they are clear when using Exhibit A.	
Yes	TIC	Yes, TIC believes the requirements are clear, appropriate, and easily identifiable and appreciates they are presented together for ease of application.	
Yes	TXCPA	The specific requirements relating to referred-to auditors are clear, appropriate and easily identifiable within the proposed SAS. Exhibit A is beneficial to the implementation of the requirements.	
Yes	VSCPA	The specific requirements relating to referred-to auditors are clear, appropriate, and easily identifiable within the proposed SAS, including exhibit A.	
12. Is the last sentence of paragraph A41 clear? (“As the magnitude of the portion of the financial statements that is audited by referred-to auditors increases, it is less likely that the group engagement partner can conclude that sufficient appropriate audit evidence can be obtained.”)			
No	BDO	We believe that the last sentence or the related application paragraph would benefit from clarifying that the group engagement partner’s assessment of the magnitude of the portion of the financial statements audited by the referred-to auditor includes quantitative and qualitative (emphasis added) considerations relating to the financial information and disclosures that could reasonably be expected to influence the economic decisions of users of the group financial statements.	
No	CLA	It is unclear at what magnitude a group engagement partner may not be able to conclude that sufficient appropriate audit evidence cannot be obtained.	
No	Eide Bailly	The last sentence in paragraph A41 as written is not clear.	
No	EY	The last sentence of paragraph A41 is unclear and may cause diversity in how auditors accept or continue a group audit engagement. For example, an entity may have three components that represent approximately 15%, 25% and 60% of the total assets and revenue of the group. One group auditor may conclude that it can obtain sufficient appropriate audit evidence by auditing the 15% and 25% components and making reference to a referred-to auditor for the 60% component. However, a different group auditor may conclude that it is unable to obtain sufficient appropriate audit evidence in the same situation.	

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		<p>While we acknowledge that professional judgment is critical in concluding on the sufficiency of appropriate audit evidence obtained, providing a figure as a starting point in the SAS would be helpful in driving consistency in practice. Consistency is especially relevant, as this matter involves the coordination of different firms. We agree with the PCAOB revised standard AS2101, <i>Audit Planning</i>, paragraph 06A, which uses the following language:</p> <p style="padding-left: 40px;">In addition, in an audit that involves referred-to-auditors (see AS1206), 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.</p> <p>We believe similar language would be helpful in the proposed SAS and would still allow interpretation and professional judgment.</p> <p>Further, we note that paragraph A41 relates only to referred-to auditors. We recommend that the ASB clarify whether the considerations in the paragraph, including the financial significance of the components and risks of material misstatements to the group financial statements associated with the components, also apply when component auditors are involved. That is, it would be helpful for the ASB to make clear whether there would ever be an instance where the component audited by a component auditor would be too significant, as determined by various criteria, for the group auditor to obtain sufficient appropriate evidence.</p>	
No	ICPAS	<p>We would suggest providing clarity over the determination of magnitude when making the assessment of the group engagement partner’s ability to obtain sufficient audit evidence, with consideration given to both quantitative and qualitative factors. For example, as it pertains to qualitative factors, we do not believe that the group engagement partner would be able to obtain sufficient audit evidence for the financial statements as a whole if there were material disclosure matters that relate to a referred-to auditor. Examples may include the identification and evaluation of commitments and contingencies, and financial statement accounts that may not be quantitatively material but possess a higher level of inherent risk due to the existence of management estimates (i.e., allowance of doubtful accounts, inventory reserves, workers compensation liabilities, etc.)). Currently, paragraph A180 refers to quantitative considerations only in the context of the consideration of magnitude, as illustrated below (emphasis added):</p> <p>A-180. The disclosure of the magnitude of the portion of the financial statements audited by a referred-to auditor may be achieved by stating <u>the dollar amounts or percentages of one or more of the following: total assets, total revenues, or other appropriate criteria</u>, whichever most clearly describes the portion of the financial statements audited by a referred-to auditor. When two or more referred-to auditors are referred to, the dollar amounts or percentages covered by the referred-to auditors may be stated in the aggregate.</p>	

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No	KPMG	<p>We believe the last sentence of paragraph A41 can be enhanced as follows (please see strikethroughs and underlined text for proposed changes):</p> <p>A41. As the magnitude of <i>and/or the risks of material misstatement to the group financial statements associated with</i> the portion of the financial statements that is audited by referred-to auditors increases, it is less likely that the group engagement partner can conclude that sufficient appropriate audit evidence can be obtained.</p> <p>This is consistent with the two bullets in paragraph A41, where the group engagement partner may consider both the financial significance of the components that are audited by the referred-to auditor, and the risks of material misstatement to the group financial statements associated with the portion of the company’s financial statements audited by the referred-to auditor, when determining whether its participation may be sufficient to serve as group auditor.</p>	
No	Mazars	No, the last sentence of paragraph A41 is not clear due to its use of the word “magnitude”.	
No	MI OAG	<p>We reject the underlying assertion of paragraph A41 that a group auditor cannot obtain sufficient appropriate audit evidence in a group audit when reference is made to referred-to auditors. Governmental auditors routinely engage private firms to audit components of the government and this reliance may be substantial, and at times constitutes a major fund, which is an entire opinion unit. We recommend the Board either eliminate this sentence or substantially revise it and incorporate “Considerations Specific to Governmental Entities” to address current accepted practices in governmental audits.</p>	
No	NSAA	No, the last sentence in A41 is not clear, and further, we believe it should be removed. In the government auditing environment, it is not uncommon for referred-to auditors to perform a substantial percentage of the audit work for an individual opinion unit. In some cases, referred-to auditors perform 100% of the audit work for an opinion unit. If the procedures outlined elsewhere in the standard for making reference to another auditor are adhered to and adequately documented, we see no reason why magnitude alone would imply that sufficient appropriate audit evidence could not be obtained by the group engagement partner.	
No	OSCPA	The committee identified this as an area where a move to a more principles-based standard leaves the room for interpretation too broad (e.g. do we mean 51%, or 90%?).	
No	SL	<p>The statement itself, is more ambiguous than preferred. We understand the move away from a rules-based or bright-line approach to a conceptual approach to application. With that being said, the extant standards allowed for the use of referred-to auditors for multiple component companies, and a group auditor performing a roll up and overall audit report. If there is reputational reliance, adequate and appropriate communication, review of working papers for significant areas, participation in planning decisions (such as, materiality), fraud risk between group and referred to auditor, this statement could allow for some to never be able to issue a report as there is no predominant group entity. We would need more clarification or guidance.</p> <p>For example, consider a private equity owned LLC, that owns multiple separate legal entities that are significant components and audited by other firms, in conjunction with the group audit approach, communications, and the group audit oversees the other audits but each entity issues its own audit.</p>	

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		This would either require responsibility and now not treat the other audits as referred-to audits, but require the group auditor to determine and decide which other audits will be referred to, and which ones will be considered to take ownership of, or not allow the group auditor to issue a report.	
No	TXCPA	Additional qualitative and quantitative application material is needed with regard to paragraph A41.	
No	VSCPA	<p>The Committee does not agree with the last sentence of paragraph A41. We believe the consideration presented in paragraph 51-66 provide assurance that the group engagement partner can conclude the sufficient appropriate audit evidence can be obtained.</p> <p>Our members who audit governments utilize referred-to-auditors often and in some cases, up to 100% of an opinion unit. It is possible that a governmental entity to have a component that is not a governmental unit audited by a firm specialized in that industry and that it would be appropriate for this practice to continue.</p> <p>We believe the Board should consider revising this sentence or eliminating it.</p>	
Yes, with suggestions	TIC	While TIC believes the last sentence is clear, there is one identified opportunity to add additional clarity. To avoid a strictly monetary magnitude interpretation, TIC recommends adding a phrase to the final sentence that incorporates the need to consider the qualitative magnitude of risks vs. solely the quantitative magnitude of the portion of the financial statements audited by the referred-to auditors.	
Yes	Crowe	Yes, the last sentence in paragraph A41 is clear.	
Yes	Deloitte	Yes.	
Yes	GAO	The last sentence of paragraph A41 is sufficiently clear in the context of paragraphs 19–20 and related application material.	
Yes	PwC	We agree the last sentence of paragraph A41 is clear.	
Yes	RSM	We believe the last sentence of paragraph A41 provides the appropriate level of guidance for the group auditor.	
12. Is there additional application material that is needed for paragraph A41, and if so, what should it be?			
Additions	CLA	We recommend the ASB provide additional guidance and examples of situations when it may not be appropriate to use a referred-to auditor.	
Additions	CLA	Examples would provide the auditor more context for applying the guidance in the last sentence of this paragraph.	
Additions	COV	We do not agree with the last sentence of paragraph A41. We believe the considerations documented in paragraphs 51 – 66, regarding referred-to auditors, provide assurance that the group engagement partner can conclude that sufficient appropriate audit evidence can be obtained. Additionally, auditors of governments utilize referred-to-auditors often, in some cases, for up to 100 percent of an opinion unit. For example, a primary government may have a component unit that is a non-governmental entity audited by a firm that specializes in audits of that particular industry. We believe it is appropriate for this practice to continue. As a result, the Board should eliminate or revise the last sentence of paragraph A41. In addition, we believe the Board should add a “Consideration Specific to Governmental Entities” to address the magnitude concept with relation to opinion units in a governmental environment or expand paragraph A43 to more clearly address magnitude considerations related to opinion units.	

Overall Opinion	Commenter	Comment	Response to Comment
Additions	Crowe	<p>We note that at this point in the engagement (acceptance and continuance), the group auditor will not likely have engaged specific referred-to auditors and will not be able to “conclude” on the ability to obtain sufficient appropriate audit evidence. Therefore, we recommend that the paragraph be modified to be more consistent with paragraph 19 and to reflect that these considerations and determinations are being made based on the group engagement partner’s expectations of the group audit plan, such as the following (<u>additions</u> / deletions):</p> <p>“The group engagement partner may consider the nature and extent of work <u>to potentially be</u> performed by referred-to auditors, including matters such as the following:</p> <ul style="list-style-type: none"> • The financial significance of the components that will <u>potentially be</u> are audited by referred-to auditors • The risks of material misstatement to the group financial statements associated with the portion of the company’s financial statements for which the group auditor or component auditor <u>expects to perform</u> performs audit procedures compared to the portion <u>that will potentially be</u> audited by referred-to auditors <p>As the magnitude of the portion of the financial statements that <u>will potentially be</u> is audited by referred-to auditors increases, it is less likely that the group engagement partner can <u>determine</u> conclude that sufficient appropriate audit evidence can <u>reasonably be expected to</u> be obtained.”</p> <p>We also suggest the following edit to the first sentence in paragraph A41: “There may be more complexities in determining whether sufficient appropriate audit evidence can reasonably be expected to be obtained in a group audit where reference is made to the audit of referred-to auditors in the auditor’s report on the group financial statements is being considered, including in group audits where no component auditors are also involved.”</p>	
Additions	Eide Bailly	<p>Providing additional clarification to understand what is implied by that last sentence would be beneficial to practitioners. The last sentence seems to suggest a size limitation at which an auditor would not be able to perform a group audit when referred-to auditors are involved. If this is what the standard is suggesting, we disagree that size limitations should result in disallowing group audits when a referred-to auditor audits a larger portion of the group financial statements. If the board intends to impose proportionate size limitations, clearer parameters and bright lines would be necessary to achieve consistency across audit firms. Otherwise, aggressive interpretations would lead to diversity and unfair practices.</p> <p>In our practice, we have a number of instances where this occurs, and these examples are common with other practitioners. For example, in governmental audits, referred-to auditors may be the only auditor for a given opinion unit such as a discretely presented component unit, individual major funds, fiduciary activities (such as retirement plans), etc. Additionally, certain investment funds, such as investors in affordable housing partnerships, are often a consolidation of individual partnership audits performed by referred-to auditors. Also, commercial entities have large subsidiaries that are audited by referred-to auditors. These are a few of the examples that would potentially have significant changes in practices if size limitations are placed on group audits involving referred-to auditors.</p>	

Overall Opinion	Commenter	Comment	Response to Comment
Additions	GT	We believe the application material can be further enhanced by providing additional considerations for the group engagement partner, such as the location of group operations and group management, and the extent of the group engagement team’s knowledge of the overall financial statements and familiarity with the group. We believe that such qualitative factors can be important considerations for determining whether the group auditor can obtain sufficient appropriate audit evidence on which to base an opinion on the group financial statements.	
Additions	Mazars	The last sentence of paragraph A41 is not clear due to its use of the word “magnitude”. Both extant AU-C section 600 and the proposed SAS paragraph A41 use the term “financial significance.” It is unclear if “magnitude” is intended to have a different meaning from “financial significance” and, if so, what that meaning is. Additional, or revised, application material clarifying the intended meaning of “magnitude” would add to greater understanding of the intent of paragraph A41.	
Additions	OSCPA	Additional guidance or more specific language (for instance, “a majority” or “substantially all”) is needed to assist in evaluating at what point the role of referred-to auditors is too significant for the group auditor to take responsibility.	
Additions	TXCPA	Additional qualitative and quantitative application material is needed with regard to paragraph A41. For example: a scenario where the referred-to auditor is doing a large portion of the audit, can the engagement partner state that he has gathered sufficient evidence to state an opinion? Saying that if referred auditor is doing so much of the audit, can the engagement auditor say he gathered sufficient appropriate evidence to render opinion. Is there a threshold where this becomes an issue? The goal of the last sentence in A41 is unclear. Additional guidance or clarification on when the referred-to auditor should be referenced in the audit report of a group audit would be helpful and provide a bright line of delineation. The PSC believes that the application of professional judgment in the determination on whether or not to specifically include the referred-to auditor may result in a broad interpretation of the requirement.	
OK as is	Deloitte	D&T believes the last sentence in paragraph A41 is clear without additional requirements or application material.	
OK as is	GAO	No additional application material is needed.	
OK as is	RSM	We believe individual audit firms should provide policies and guidance, if needed, as they discern the pertinent risks in the relationship between the portion of the financial statements audited by the referred-to auditor and the group auditor’s ability to obtain sufficient appropriate audit evidence.	
13. Does the proposed effective date provide sufficient time for preparers, auditors, and others to adopt the new standard and related conforming amendments, including sufficient time to support effective implementation of the proposed SAS?			
Yes	BDO	We are supportive of the proposed effective date and believe that it will provide sufficient time to implement the changes necessary with respect the proposed SAS. We believe that maintaining alignment of this proposed SAS with the effective date of the proposed QM SAS is appropriate.	
Yes	CLA	We believe the proposed effective date provides sufficient time to adopt the new standard and effectively implement the proposed SAS.	
Yes	COV	We believe the proposed effective date provides sufficient time to adopt the new standard and related conforming amendments, to include effective implementation.	
Yes	Crowe	Yes. We believe that the proposed effective date, for audits of group financial statements for periods ending on or after December 15, 2026, is appropriate. It is important to align the effective date of this proposed SAS with the effective date of the proposed QM SAS.	

Agenda Item 3A – Group Audits, Comment Letter Summary

Overall Opinion	Commenter	Comment	Response to Comment
Yes	Deloitte	Yes. D&T supports the proposed effective date. D&T strongly believes it is imperative that the effective date of the proposed SAS aligns with the effective date of the proposed QM SAS given that the proposed QM SAS is foundational to the proposed SAS.	
Yes	Eide Bailly	Yes, we believe the proposed effective date noted in paragraph 14 provides sufficient time for preparers, auditors, and others to adopt the new standard.	
Yes	EY	The proposed effective date would provide sufficient time to adopt the new standards.	
Yes	GAO	We believe that the proposed effective date provides sufficient time for preparers, auditors, and others to adopt the new standard and related conforming amendments, including sufficient time to support effective implementation of the proposed SAS.	
Yes	ICPAS	Yes.	
Yes	KPMG	We believe that the proposed effective date provides sufficient time to adopt the new standard and related conforming amendments.	
Yes	MI OAG	We agree that the effective date of the proposed standard is reasonable and will provide auditors sufficient time to implement the new standard.	
Yes	NSAA	We believe the proposed effective date, for audits of group financial statements for periods ending on or after December 15, 2026, provides sufficient time to implement the new standard.	
Yes	OSCPA	The committee found the proposed implementation date of December 15, 2026, unnecessarily long, but understands wanting to coordinate with the effective date of the quality management standards.	
Yes	PwC	We appreciate that the ASB has aligned the proposed effective date of the proposed SAS with the effective date of SAS 146. We believe the proposed effective date provides sufficient time for effective implementation.	
Yes	RSM	We believe the proposed effective date provides sufficient time for preparers, auditors and others to adopt the new standard and related conforming amendments, including sufficient time to support effective implementation of the proposed SAS.	
Yes	SL	Yes, an effective date for audits of group financial statements for periods ending on or after December 15, 2026, is reasonable. This would include audits of smaller entities who rely on service providers to develop the coinciding audit methodology (and the related work by firms to understand and prepare trainings to our audit teams) with the expectation that interim financial statements reviewed under AU-C section 930 would adopt for Q1 2026.	
Yes	TIC	Yes, TIC believes there is sufficient time to adopt the new standard and noted its alignment with the QM Standards.	
Yes	TXCPA	The PSC agrees that the proposed effective date provides sufficient time for adoption and implementation, especially since the SQMSs have been delayed until 2025.	
Yes	VSCPA	The Committee believes the proposed effective date provides sufficient time for all parties to adopt the new standard and the related conforming amendments.	
Other Comments			
Editorial			
	Crowe	In paragraph 15, where the proposed SAS presents the “objectives of the auditor”, we recommend this be changed to “objectives of the group auditor”.	
	PwC	<i>Involvement of Component Auditors</i>	

Overall Opinion	Commenter	Comment	Response to Comment
		<p>.8. The group auditor may involve component auditors to provide information, or to perform audit work, to fulfill the requirements of this proposed SAS. Component auditors may have greater experience with, and a more in-depth knowledge of, the components and their environments (including local laws and regulations, business practices, language, and culture) than the group auditor. Accordingly, component auditors can be, and often are, involved in all phases of the group audit <u>under the direction and supervision of the group auditor.</u> (Ref: par. A10–A11) [To further differentiate component auditors and referred-to auditors and to temper discussion of the use of component auditors]</p>	
	PwC	<p><i>Making Reference to the Audit of a Referred-To Auditor</i></p> <p>.10 <u>In accordance with</u> this proposed SAS, –also describes the procedures to be followed to obtain sufficient appropriate audit evidence when the group engagement partner can also determines to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements <u>in circumstances when the referred-to auditor has performed an audit of the financial information of a component.</u> Reference in the auditor's report on the group financial statements to the fact that part of the audit was conducted by a referred-to auditor communicates the source of audit evidence with respect to those components for which such reference is made. <u>Because the group auditor does not direct, supervise, or review the work of a referred-to auditor, a</u> referred-to auditor is not a component auditor, and accordingly, a referred-to auditor is not a part of the engagement team. Therefore, when the terms <i>component auditor</i> and <i>engagement team</i> are used in this proposed SAS, they do not include referred-to auditors. <u>Paragraphs .51-.57 set out requirements to enable</u> Therefore, when the group engagement partner to determine whether plans to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements <u>when establishing the overall group audit strategy and group audit plan in accordance with paragraph 24 of this proposed SAS. The these requirements in paragraphs .58-.65, in addition to other requirements related to the execution of the group audit, are relevant when the group engagement partner determines to make reference.</u> [To further tee up the concept of referred-to auditors and separate the requirement to determine if it is appropriate to make reference]]</p> <p>Relates to Request for Comment No. 11</p>	
	PwC	<p><i>Responsibilities of the Group Engagement Partner and Group Auditor</i></p> <p>13. The group engagement partner remains ultimately responsible, and therefore accountable, for compliance with the requirements of this proposed SAS. <u>Nevertheless, the group engagement partner may seek assistance from others to fulfill these responsibilities.</u> The phrase “the group engagement partner should take responsibility for...” or “the group auditor should take responsibility for...” is used for those requirements <u>for which</u> when the group engagement partner or group auditor, respectively, is permitted to assign the design or performance of procedures, tasks, or actions to other appropriately skilled or suitably experienced members of the engagement team, including component auditors. For other requirements, this proposed SAS expressly intends that the requirement or responsibility be fulfilled</p>	

Overall Opinion	Commenter	Comment	Response to Comment
		<p>by the group engagement partner or group auditor, as applicable, and <u>In such circumstances,</u> the group engagement partner or group auditor may <u>need to</u> obtain information from the firm or other members of the engagement team. <u>For example, when others, including component auditors, perform supervisory and review activities, the outcome of those activities can be taken into account by the group engagement partner in fulfilling these responsibilities.</u> (Ref: par. A19, A33) [To align with paragraph 9 of SAS 146]</p>	
	PwC	<p>16. component auditor. An auditor who performs audit work related to a component for purposes of the group audit <u>under the direction and supervision of the group auditor.</u> A component auditor is a part of the engagement team² for a group audit. <u>A referred-to auditor is not a component auditor, and accordingly, is not a part of the engagement team for a group audit.</u> (Ref: par. A23–A26) [To reiterate the difference between component auditors and referred-to auditors]</p> <p>Relates to Request for Comment No. 6</p>	
	PwC	<p>Overall Group Audit Strategy and Group Audit Plan</p> <p>.24 In applying AU-C section 300,³ the group auditor should establish, and update as necessary, an overall group audit strategy and group audit plan. In doing so, the group auditor should determine the following: (Ref: par. A54–A58)</p> <p>...</p> <p>b. The components for which, if any, the auditor’s report on the group financial statements will make reference to the audit of a referred-to auditor <u>when the group auditor has determined it is appropriate to do so in accordance with the requirements of paragraphs .51-.5765.</u> [To note that this is a specific judgment that must be made]</p>	
	PwC	<p>Considerations When Component Auditors Are Involved</p> <p>.33 The group auditor should communicate the following to component auditors on a timely basis: (Ref: par. A116)</p> <p>a. Matters that the group auditor determines to be relevant to the component auditor’s design or performance of risk assessment procedures for purposes of the group audit, including identified significant risks of the group financial statements <u>that are relevant to the work of the component auditor</u> [To be consistent with the other bullets and</p>	

² Paragraph 12 of QM SAS

³ Paragraphs 7-10 of AU-C section 300

Overall Opinion	Commenter	Comment	Response to Comment
		<p style="text-align: center;">reiterate that the communications focus on what is relevant to the work being performed at the component vs. suggesting all significant risks of the group financial statements are relevant to the component]</p>	
	PwC	<p>Considerations Regarding Making Reference to the Audit of a Referred-to Auditor in the Auditor's Report on the Group Financial Statements</p> <p><i>Understanding the Referred-To Auditor and Determining Whether to Make Reference</i></p> <p>Relevant Ethical Requirements, Including Those Related to Independence, for Referred-To Auditors</p> <p>.51 When making reference to the audit of a referred-to auditor, the group engagement partner should take responsibility for (Ref: par. A165)</p> <p style="padding-left: 40px;">a. <u>obtaining an understanding of whether</u> referred-to auditors have ing been made aware of relevant ethical requirements that are applicable given the nature and circumstances of the group audit engagement; and [To align more closely with extant AU-C section 600. Note that the PCAOB standard simply requires a written representation that the referred-to auditor is independent similar to paragraph 63; also note this is somewhat duplicative of paragraph 62]</p> <p>...</p> <p>Competence and Capabilities of Referred-To Auditors</p> <p>.52 When making reference to the audit of a referred-to auditor, the group engagement partner should take responsibility for <u>understanding whether</u> determining that referred-to auditors have the appropriate competence and capabilities. (Ref: par. A166–A168) [To align more closely with extant AU-C section 500. Note that the PCAOB standard requires the lead auditor to make inquiries of the referred-to auditor and look to other information obtained during the audit]</p> <p>.53 The group auditor should obtain sufficient appropriate audit evidence relating to the work to be performed at the component without making reference to the audit of a referred to auditor in the auditor's report on the group financial statements if: (Ref: par. A169–A170)</p> <p style="padding-left: 40px;">a. the referred to auditor does not comply with the relevant ethical requirements, including those related to independence, that apply to the group audit engagement; or</p> <p style="padding-left: 40px;">b. the group engagement partner has serious concerns about the matters in paragraphs .51-.52. [Moved below to assist in the flow of the requirements]</p> <p>Consolidation Process Considerations for Referred-To Auditors</p> <p>.534 When making reference to the audit of a referred-to auditor, the group auditor should obtain an</p>	

Overall Opinion	Commenter	Comment	Response to Comment
		<p>understanding of whether the group auditor will be able to obtain information affecting the consolidation process from group management or a referred-to auditor.</p> <p>Determining Whether to Make Reference to the Audit of a Referred-To Auditor (Ref: par. A171–A178)</p> <p>.545 Having obtained an understanding of the referred-to auditor in paragraphs .51–5354, the group engagement partner should determine whether to make reference to the audit of a referred-to auditor in the auditor’s report on the group financial statements.</p> <p>.556 Reference to the audit of a referred-to auditor in the auditor’s report on the group financial statements should not be made unless:</p> <ul style="list-style-type: none"> a. the group engagement partner has determined that the referred-to auditor has performed an audit of the financial statements of the component in accordance with the relevant requirements of GAAS or the standards promulgated by the PCAOB (Ref: par. A174), and b. the referred-to auditor has issued an auditor’s report that is not restricted as to use. <p><u>.56 The group auditor should obtain sufficient appropriate audit evidence relating to the work to be performed at the component without making reference to the audit of a referred-to auditor in the auditor’s report on the group financial statements if: (Ref: par. A169–A170)</u></p> <ul style="list-style-type: none"> a. <u>the referred-to auditor does not comply with the relevant ethical requirements, including those related to independence, that apply to the group audit engagement; or</u> b. <u>the group engagement partner has serious concerns about the matters in paragraphs .51.52. [Moved from above, this is not explicitly addressed in PCAOB standards]</u> <p>Relates to Request for Comment No. 11</p>	
	PwC	<p>Subsequent Events</p> <p>.66 In applying AU-C section 560,⁴ the group auditor should take responsibility for performing procedures, including, as appropriate, requesting component auditors or referred-to auditors to perform procedures, designed to identify events that may require adjustment of, or disclosure in, the group financial statements. (Ref: par. A185–A187)</p> <p style="text-align: center;"><i>Considerations When Component Auditors or Referred-to Auditors Are Involved</i></p> <p>.67 The group auditor should request the component auditors <u>and referred-to auditors, as applicable</u>, to notify the group auditor if they become aware of subsequent events that may require adjustment of, or disclosure in, the group financial statements. (Ref: par. A187) [This requirement is equally relevant to</p>	

⁴ Paragraphs 9-10 of AU-C section 560, Subsequent Events and Subsequently Discovered Facts

Overall Opinion	Commenter	Comment	Response to Comment
		<p>referred-to auditors, could consider placing it elsewhere]</p> <p>Relates to Request for Comment No. 11</p>	
	PwC	<p>Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained</p> <p>...</p> <p>.69 The group engagement partner should evaluate the effect on the group audit opinion of any uncorrected misstatements (whether identified by the group auditor or communicated by component auditors) <u>or other communications from component auditors and, as applicable, referred to auditors, including</u> and any instances when there has been an inability to obtain sufficient appropriate audit evidence. (Ref: par. A193) [To encourage auditors to consider any additional information from referred-to auditors]</p>	
	PwC	<p><i>Components at Which to Perform Audit Work</i> (Ref: par. 24a)</p> <p>A59. The determination of components at which to perform audit work is a matter of professional judgment. The following are examples of matters that may influence the group auditor's determination:</p> <ul style="list-style-type: none"> • <u>The nature and significance of individual entities or business units included in the group financial statements, including the nature of events or conditions that may give rise to risks of material misstatement at the assertion level of the group financial statements that are associated with a component, for example</u> <ul style="list-style-type: none"> ○ newly formed or acquired entities or business units, ○ entities or business units in which significant changes have taken place, ○ significant transactions with related parties, ○ significant unusual transactions, and ○ abnormal fluctuations identified by analytical procedures performed at the group level, in accordance with AU-C section 315. • <u>The specific risks associated with an individual entity or business unit, including whether those risks</u> <ul style="list-style-type: none"> ○ <u>represent significant risks or</u> ○ <u>apply to other entities or business units included in the group financial statements, such that these risks, in combination, represent a risk of material misstatement</u> • The disaggregation of significant classes of transactions, account balances, and disclosures in the group financial statements across components, considering the size and nature of assets, liabilities, and transactions at the location or business unit relative to the group financial statements • Whether sufficient appropriate audit evidence is expected to be obtained for all significant 	

Overall Opinion	Commenter	Comment	Response to Comment
		<p>classes of transactions, account balances, and disclosures in the group financial statements from audit work planned on the financial information of identified components</p> <ul style="list-style-type: none"> ● The nature and extent of misstatements or control deficiencies identified at a component in prior period audits ● The extent of the commonality of controls across the group and whether, and if so, how, the nature and group centralizes activities relevant to financial reporting [To incorporate additional guidance related to the extant concepts of significant components and the type of work to be performed as well as guidance from PCAOB AS 2101] 	
	PwC	<p>A62. Component auditors may be involved in different phases of an audit. For example, component auditors may design or perform</p> <ul style="list-style-type: none"> ● risk assessment procedures, and/or ● procedures to respond to the assessed risks of material misstatement. 	
	PwC	<p><i>The Nature and Extent of Further Audit Procedures</i></p> <p>A144. <u>In applying AU-C section 330, the nature, timing, and extent of further audit procedures at components are expected to be based on, and responsive to, the assessed risks of material misstatement of the group financial statements.</u> In response to the assessed risks of material misstatement, the group auditor may determine the following scope of work to be appropriate at a component (with the involvement of component auditors, as applicable):</p> <ul style="list-style-type: none"> ● Design and perform further audit procedures on the entire financial information of the component ● Design and perform further audit procedures on one or more classes of transactions, account balances, or disclosures ● Perform specific further audit procedures 	
	PwC	<p>Design and Perform Further Audit Procedures on One or More Classes of Transactions, Account Balances, or Disclosures</p> <p>A148. The group auditor may determine that designing and performing further audit procedures on one or more particular classes of transactions, account balances, or disclosures of the financial information of a component is an appropriate approach to address assessed risks of material misstatement of the group financial statements. For example, a component may have limited operations but hold a significant portion of the land and buildings of the group or have significant tax balances. <u>In such cases, the component auditor may exercise professional judgment in determining the nature, timing and extent of procedures to be performed, taking into account component materiality.</u></p>	

Overall Opinion	Commenter	Comment	Response to Comment
		<p>Perform Specific Further Audit Procedures</p> <p>A149. The group auditor may determine that designing and performing specific further audit procedures on the financial information of a component is an appropriate approach, including to complement testing performed by the group auditor, such as when audit evidence needs to be obtained for one or more relevant assertions only. For example, the group auditor may</p> <ul style="list-style-type: none"> • centrally test the class of transaction, account balance, or disclosure and may require the component auditor to perform specific further audit procedures at the component (for example, specific further audit procedures related to the valuation of claims or litigations in the component’s jurisdiction or the existence of an asset <u>or the observation of inventory counts</u>). • <u>request one or more component auditors to perform tests of controls related to significant classes of transactions, account balances, and disclosures.</u> • <u>request a component auditor to perform procedures to obtain audit evidence related to one or more relevant assertions, and may specify the sample sizes to be used (e.g., in the case of a component auditor who is from a different network and therefore not subject to common audit methodologies or to drive consistency in testing across components with similar characteristics).</u> 	
	RSM	<p>We note that paragraph 16 of the proposed SAS defines aggregation risk as “the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole” and paragraph A20 of the proposed SAS states:</p> <p>Aggregation risk exists in all audits of financial statements but is particularly important to understand and address in a group audit because there is a greater likelihood that audit procedures will be performed on classes of transactions, account balances, or disclosures that are disaggregated across components. Generally, aggregation risk increases as the number of components at which audit procedures are performed separately increases, whether by component auditors or other members of the engagement team.</p> <p>We agree that aggregation risk is particularly important to understand and address in a group audit. We believe, however, that aggregation risk increases as a result of a myriad of factors, including, but not limited to, the extent of disaggregation of the financial information across components and the nature, frequency and magnitude of misstatements in the component financial information. The auditor responds to aggregation risk by reducing the component performance materiality to an appropriately low level for the audit procedures performed separately on the financial information of components across the group. We suggest consideration be given to deleting the last sentence of paragraph A20 of the proposed SAS.</p>	
	RSM	<p>We note that Exhibit A indicates the requirements in paragraph 36 of the proposed SAS are relevant for all of the various group audit scenarios. However, the header immediately preceding paragraph 36 states “Considerations When Component Auditors Are Involved.” We agree that the requirements in paragraph</p>	

Overall Opinion	Commenter	Comment	Response to Comment
		<p>36 are relevant for all of the various group audit scenarios, and therefore suggest removing this header.</p> <p>Relates to Request for Comment No. 4b</p>	
	RSM	<p>We note that paragraph A205 of the proposed SAS states that the audit documentation for the group audit comprises (a) the documentation in the group auditor’s file and (b) the separate documentation in the respective component auditor files relating to the work performed by the component auditors for purposes of the group audit (that is, component auditor audit documentation). We therefore are curious as to why the word “ordinarily” is needed in the first sentence of paragraph A213, which states, “Component auditor audit documentation ordinarily need not be replicated in the group auditor’s audit file.” We suggest that, if there are circumstances in which it is necessary for the group auditor’s file to replicate the component auditor audit documentation, those circumstances should be articulated in the proposed SAS. Otherwise, we suggest consideration be given to removing the word “ordinarily” from the first sentence of paragraph A213.</p> <p>Relates to Request for Comment No.5</p>	
	RSM	<p>We note that the proposed addition of paragraph .33.d.ii. to AT-C Section 105, <i>Concepts Common to All Attestation Engagements</i>, would require a determination of the sufficiency of time to perform procedures. In addition to suggesting that additional guidance be provided regarding how this determination is made, we suggest the wording of this new paragraph be revised to sync with the terminology used elsewhere in paragraph .33 of AT-C Section 105 as follows (our proposed addition is noted in bold font, and our proposed deletions are struck through):</p> <p style="padding-left: 40px;">ii. determine that the other auditor practitioner has sufficient time to perform assigned audit procedures, and</p>	
	RSM	<p>Currently, AU-C 600 requires the group auditor to determine performance materiality for those components on which the group engagement team will perform, or request a component auditor to perform, an audit or review. Paragraph 37 of the proposed SAS would require the group auditor to determine component performance materiality for those components on which the group auditor or component auditor will perform audit procedures. We believe consideration should be given to changing paragraph 37 to read as follows (additions shown in bold font):</p> <p style="padding-left: 40px;">In applying AU-C section 320, <i>Materiality in Planning and Performing an Audit</i>, and AU-C section 450, <i>Evaluation of Misstatements Identified During the Audit</i>, when classes of transactions, account balances, or disclosures in the group financial statements are disaggregated across components, for purposes of planning and performing audit procedures, for those components on which the group auditor or component auditor will perform audit or review procedures, the group auditor should determine the following:</p> <p style="padding-left: 40px;">a. Component performance materiality. To address aggregation risk, such amount should be lower than group performance materiality. (Ref: par. A127–A133)</p>	

Overall Opinion	Commenter	Comment	Response to Comment
		<p>b. The threshold above which misstatements identified in the component financial information are to be communicated to the group auditor. Such threshold should not exceed the amount regarded as clearly trivial to the group financial statements. (Ref: par. A134)</p>	
	RSM	<p>We note that in the first sentence of the “Basis for Qualified Opinion” section of Exhibit B on page 107 of the proposed SAS, “thenended” should be changed to “then ended.”</p>	
	SL	<p>It appears, that on proposed paragraph A221:</p> <p><i>Basis for Qualified Opinion</i></p> <p>We were unable to obtain audited financial statements supporting the Company's investment in a foreign affiliate stated at \$XXX and \$XXX at December 31, 20X1 and 20X0, respectively, or its equity in earnings of that affiliate of \$XXX and \$XXX, which is included in net income for the years <u>then ended</u> as described in Note X to the consolidated financial statements; nor were we able to satisfy ourselves as to the carrying value of the investment in the foreign affiliate or the equity in its earnings by other auditing procedures. The example has a spacing issue at the then ended at “years <u>then ended</u> as described in Note X.”</p>	
Application Materials/Guidance			
	Crowe	<p>We note that the extant AU-C section 600 includes the following application guidance: “.A65 Consideration of all components, regardless of whether reference is made in the auditor’s report on the group financial statements to the audit of a component auditor, is necessary when determining component materiality to reduce the risk that the aggregate of detected and undetected misstatements in the group financial statements exceeds materiality for the group financial statements as a whole. Determining component materiality is necessary for the group engagement team to determine the overall group audit plan for the components for which the auditor of the group financial statements is not making reference to the component auditor.”</p> <p>We believe similar application guidance should be included in the proposed SAS. While the group auditor is not taking responsibility for the portion of the group for which the group auditor is referring to a referred-to auditor, the group auditor still must consider all components to sufficiently address aggregation risk in the group financial statements and to develop the audit plan for the components for which the group auditor is taking responsibility. Without such guidance, we believe that group auditors may not design and plan their audits to sufficiently reduce the aggregation risk inherent in a group audit.</p> <p>In addition, related to the definition of component in paragraph 16 of the proposed SAS, we believe it would be beneficial to include application guidance to help auditors of employee benefit plans understand scenarios where a plan may have more than one component. The following is suggested language, which we recommend placing after paragraph A22:</p>	

Overall Opinion	Commenter	Comment	Response to Comment
		<p><i>Considerations Specific to Employee Benefit Plans</i> (Ref: par. 16) In audits of employee benefit plans, a component may be a separate legal entity or subsidiary, or part of the plan which operates separately, such as in a plan merger where the merged plans are still being administered separately and the assets of the merged plans are being held in separate trusts.</p>	
	EY	<p>We believe there is a risk that without sufficient guidance for the following situations, firms may not apply the requirements consistently:</p> <ul style="list-style-type: none"> • Our understanding is that the “use of the work of another practitioner” in the first sentence of paragraph 33 of AT-C section 105 is not intended to address all situations in which the work of another practitioner is used (for example, a service auditor’s report). We encourage the Board to clarify the distinction between “use of the work of another practitioner” and reliance on another practitioner’s report in this paragraph or in the application paragraph. • We believe the ASB should consider new guidance or clarifications to existing guidance to address how an auditor should apply procedures over attestation reports other than service organization reports. We have observed an increase in the use of other reports as audit evidence and believe guidance is needed in this area. 	
	PwC	<p>We encourage the ASB to consider whether it might be helpful to develop illustrative interoffice/interfirm reports, for inclusion either in the proposed SAS or as non-authoritative guidance to support the standard. Doing so may help build consistency in practice. Alternatively, this could be undertaken as part of a broader exercise to determine whether other examples of how firms in the US may be requested to communicate with each other (e.g., in the case of predecessor/successor auditors) would be helpful to auditors.</p>	
	RSM	<p>Paragraph 28 of the proposed SAS requires the group engagement partner to determine that component auditors have sufficient time to perform the assigned audit procedures at the component. We believe it would be helpful if additional guidance was provided in paragraph .A70 regarding how the group engagement partner would determine whether component auditors have sufficient time to perform the assigned audit procedures at the component.</p>	
	RSM	<p>We note that the AICPA has issued technical questions and answers (e.g., question .23 of Q&A Section 8800) related to the performance of group audits, which will need to be updated upon the finalization of the proposed SAS.</p>	
	TXCPA	<p>The PSC thought it would be helpful to address SOC letters in the group audit process, including an example depicting testing controls at a Service Center.</p>	

Overall Opinion	Commenter	Comment	Response to Comment
Requirements			
	Crowe	<p>Paragraph 28a requires that the group engagement partner “Determine that component auditors have the appropriate competence and capabilities, including sufficient time, to perform the assigned audit procedures at the component”. While we agree that the group engagement partner must evaluate the competence and capabilities of a component auditor, we are unclear how the group engagement partner can “determine” that the component auditor has “sufficient time” to perform their work. Further, we note an explicit documentation requirement related to this in paragraph 76. A208 indicates that “The group auditor also may ask for confirmation that the component auditor has sufficient time to perform the assigned audit procedures.” The group engagement partner likely does not have access or visibility to the resource capacity or scheduling of the component auditor; thus, it is unclear how the group engagement partner could satisfy this requirement other than to confirm with the component auditor. This element of the requirement in 28a does not appear to contribute meaningfully to audit quality. We recommend that “including sufficient time” be removed from the requirement in paragraph 28a and included only in the related application guidance. Alternatively, or in addition, the application guidance could be modified to provide additional ways in which the group engagement partner might determine if the component auditors have sufficient time allotted to perform their assigned procedures.</p>	
	Crowe	<p>Paragraph 32 in the proposed SAS repeats some, but not all, of paragraph 19 from AU-C section 315 (as modified by SAS No. 145). We are unclear why some required elements from AU-C section 315, specifically related to inherent risk factors that may give rise to the existence of risks of material misstatement of the group financial statements at the assertion level, are only provided in application guidance and Appendix B. We believe this creates the potential for auditors to overlook those elements of the requirements of AU-C section 315, if they are focused on the content included in paragraph 32 of the proposed SAS on group audits.</p> <p>Relates to Request for Comment No.1b</p>	
	Crowe	<p>We agree with paragraph A128 in the proposed SAS that the group auditor does not need to determine component materiality for components that are audited by referred-to auditors. However, we believe that the group auditor does need to take into consideration the portion of the group financial statements being audited by referred-to auditors when determining the component materiality to use for the components to be audited by the group auditor or through involving component auditors. As stated in paragraph A19 of the proposed SAS, regardless of whether reference is made in the auditor’s report on the group financial statements to the report of a referred-to auditor, the group engagement partner or the group engagement partner’s firm is responsible for the group audit opinion.</p>	
	Crowe	<p>We also agree with the content in paragraphs 22 and 23 of the proposed SAS and the related application guidance in A42. However, we note that the requirements in paragraphs 22 and 23 relate to when the group engagement partner “concludes that it will not be possible for the group auditor to obtain sufficient appropriate audit evidence due to restrictions imposed by group management”. We find that in the acceptance and continuance phase, it is unlikely the group engagement partner can definitively make such a conclusion. The application guidance in A42 relates to the situation where “Restrictions may be imposed after the group engagement partner’s acceptance of the group audit engagement.” We suggest that paragraphs 22 and 23 be revised to reflect the group engagement</p>	

Overall Opinion	Commenter	Comment	Response to Comment
		<p>partner’s considerations and expectations in the acceptance and continuance stage of the engagement, which could lead to a decision not to accept the engagement, as noted in paragraph 23.a.i. Further, we suggest that the requirements in paragraph 22 and 23 based on the determinations made post-acceptance of the group audit engagement be relocated to a separate section of the proposed SAS, along with the related application guidance.</p>	
	Deloitte	<p>In February 2022, the International Ethics Standards Board for Accountants (IESBA) issued an exposure draft, <i>Proposed Revisions to the Code Related to the Definition of Engagement Team and Group Audits</i>, which proposed revisions to the International Code of Ethics for Professional Accountants to take into account changes made to the IAASB’s quality management suite of standards and group audits standard, particularly the expansion of the definition of engagement team to include non-network component auditors. We recommend that the Professional Ethics Executive Committee (“PEEC”) of the AICPA monitor this IESBA project and undertake its own project to revise the AICPA’s Code of Professional Conduct (“the Code”) for convergence purposes. As part of considering what changes are needed to the Code, it is important for PEEC to clearly articulate the independence requirements of non-network component auditors and ensure that these independence requirements are focused on relationships with those entities that are more likely to threaten the individual’s independence, which may be different from those requirements necessary when a component auditor is from a network firm. Please see the Deloitte Touche Tohmatsu comment letter to the IESBA exposure draft for our detailed thoughts on amendments to the ethics and independence requirements. We also recommend that a PEEC project be undertaken in the near term so that the effective date of the proposed SAS and the effective date of proposed changes to the Code can be aligned as much as possible.</p>	
	John Keyser	<p>Paragraph 66 requires the group auditor to request the performance of audit procedures to identify subsequent events by the component or referred-to-auditors. However, paragraph 67 requires the group auditor to request the component auditors to notify them if they become aware of subsequent events. I recommend that paragraph 67 also require this request to be made of referred-to-auditors.</p>	
	KPMG	<p>We included additional comments below related to ethics requirements, including those related to independence, for the Board’s consideration.</p> <p>i. The International Ethics Standards Board for Accountants released the Exposure Draft <i>Proposed Revisions to the Code Relating to the Definition of Engagement Team and Group Audits</i> (IESBA ED), with proposed revisions to the International Code of Ethics for Professional Accountants (the IESBA Code). Paragraph A68 of the proposed SAS noted that “when the component auditor is not subject to the AICPA Code of Professional Conduct, compliance by the component auditor with the ethics and independence requirements set forth in the International Federation of Accountants Code of Ethics for Professional Accountants is sufficient to fulfill the component auditor’s ethical responsibilities in the group audit”. As the proposed SAS allows for compliance with the IESBA Code, we recommend the Board to consider the interaction of the IESBA ED and the proposed SAS as it relates to compliance with ethical requirements, including those related to independence, particularly with regard to non-network component auditors involved in a group audit.</p> <p>For example, the IESBA ED includes provisions requiring individuals participating in the group audit (including those from a non-network component audit firm) to be independent of the group and the</p>	

Overall Opinion	Commenter	Comment	Response to Comment
		<p>group’s related entities (affiliates). The IESBA ED proposes separate independence requirements applicable to non-network component auditor firms. KPMG International has provided responses to the IESBA ED via a separate comment letter that we attached for your reference (particularly our response to question 4 in Appendix A). If the provisions in the IESBA ED are adopted as proposed, the IESBA Code may include different independence requirements from those outlined in the proposed SAS. We recommend the Board to consider such interaction and provide further guidance as necessary to drive consistent application in practice.</p> <p>ii. We appreciate the conforming amendments outlined in Appendix C of the Exposure Draft. As <i>referred-to auditor</i> is a new term defined in the proposed SAS, we recommend the Board also consider working with the Professional Ethics Executive Committee on conforming amendments to the AICPA Code of Professional Conduct by incorporating referred-to auditor where appropriate (in particular paragraph 0.200.020.03c) when <i>component auditor</i> is currently used.</p>	
	PwC	<p>We support the enhanced focus expressed in paragraph 32 of the proposed SAS to understand the group and its environment. The structure of a group and its financial reporting processes and controls play a significant role in determining how best to approach a group audit, the key judgments that need to be made around the determination of components, and how component auditors are involved in the audit. Such judgments need to be based on a preliminary understanding of how management views and controls the business, taking into account the group, its structure, its financial reporting processes, and system of internal control. Different approaches may be justified depending on the group’s structure and circumstances.</p> <p>We understand the benefit of enhanced focus on describing how component auditors may support the identification and assessment of risks of material misstatement of the group financial statements, and the design of procedures to respond to those assessed risks. However, the proposed SAS should not be read as suggesting that it is always necessary to involve component auditors in this manner (e.g., the group auditor may choose not to involve the component auditor in the risk assessment when the work at the component comprises only “specific further audit procedures”).</p>	
	SL	<p>The inclusion of a named referred-to auditor auditor’s report seems a little excessive in terms of burden on the group auditor. If the referred-to auditor is stated and named, along with date of the referred-to auditor’s report, that should be more than sufficient, without increased burden on obtaining a copy of the report for inclusion. Some firms may agree to being mentioned or named, but providing a copy of a report separate and secured and tied to the financials for which they were issued with, could provide undue risk to the fraudulent use of an auditor’s report, letterhead, or signature, or could be taken out of context and exposing the referred-to auditor to risk associated with the group company, outside of their scope of the component.</p> <p>Relates to Request for Comment No.11</p>	
Clarification Needed			
	CLA	We recommend the ASB clarify the responsibilities of component auditors when performing audit procedures designed by group auditors from a firm other than the component auditor’s firm.	

Overall Opinion	Commenter	Comment	Response to Comment
		Specifically, we recommend the ASB provide additional guidance regarding the nature of the component auditor’s engagement and the form of communicating the component auditor’s overall findings and conclusions.	
	Crowe	We agree that the group auditor should take responsibility for the identification and assessment of the risks of material misstatement of the group financial statements and the nature, timing, and extent of further audit procedures to be performed. We find it appropriate and beneficial to audit quality to clarify in the proposed SAS that the group auditor is permitted to assign the design or performance of procedures, tasks, or actions to other appropriately skilled or suitably experienced members of the engagement team, including component auditors. We note that in many cases, a component auditor may have more experience with and/or more detailed knowledge about a particular component and its environment, such as in the case where the component auditor also performs a stand-alone audit for that component. The component auditor may be in the best position to design and perform further audit procedures.	
	Crowe	<p>Related to the definition of component, we note that the extant standard provides the following: “An entity or business activity for which group or component management prepares financial information that is required by the applicable financial reporting framework to be included in the group financial statements.” We believe that the preparation of financial information is a key element of the identification of a component. We recommend the ASB re-insert such language in the definition of component in the proposed SAS.</p> <p>Relates to Request for Comment No. 6</p>	
	Deloitte	<p>Paragraph A96 of the proposed SAS states that the group engagement partner may become aware of information about noncompliance or suspected noncompliance with law or regulations, and in such circumstances, may have an obligation under relevant ethical requirements, laws, or regulations to communicate the matter to the component auditor. Paragraphs 22-23 of the “Responding to Noncompliance With Laws and Regulations” interpretation of the AICPA Code of Professional Conduct (“the interpretation”), as adopted by PEEC in February 2022, address such relevant ethical requirements:</p> <p><i>.23 If the group audit engagement partner becomes aware of noncompliance or suspected noncompliance in the course of a group audit engagement, including as a result of being informed of such a matter in accordance with paragraph .22, the group audit engagement partner should, in addition to responding to the matter in the context of the group audit engagement in accordance with the provisions of this section, consider whether the matter may be relevant to one or more components whose financial or other information is subject to procedures performed for purposes of the group audit engagement.</i></p> <p><i>In these circumstances, the group audit engagement partner should take steps to have the noncompliance or suspected noncompliance communicated to those performing work at components where the matter may be relevant, unless prohibited from doing so by law or</i></p>	

Overall Opinion	Commenter	Comment	Response to Comment
		<p style="text-align: center;"><i>regulation.</i></p> <p>In considering the interpretation, we acknowledge certain definitional changes in the proposed SAS. The proposed SAS changes the definition of the term component auditor and introduces the term referred-to auditor. The extant AU-C section 600 definition of component auditor includes both (a) an auditor whose work the group engagement partner assumes responsibility for, and (b) an auditor whose work the group engagement partner does not assume responsibility for, and accordingly, makes reference to. The auditor described in (b) is no longer defined as a component auditor in the proposed SAS, and instead, is defined as a referred-to auditor. Definitions are as follows:</p> <p style="text-align: center;"><u>Definitions in Extant AU-C Section 600</u></p> <p>Component auditor. <i>An auditor who performs work on the financial information of a component that will be used as audit evidence for the group audit. A component auditor may be part of the group engagement partner’s firm, a network firm of the group engagement partner’s firm, or another firm.</i></p> <p style="text-align: center;"><u>Definitions in the Proposed SAS</u></p> <p>Component auditor. <i>An auditor who performs audit work related to a component for purposes of the group audit. A component auditor is a part of the engagement team for a group audit.</i></p> <p>Referred-to auditor. <i>An auditor who performs an audit of the financial statements of a component to which the group engagement partner determines to make reference in the auditor’s report on the group financial statements. A referred-to auditor is not a component auditor, and accordingly, is not a part of the engagement team for a group audit.</i></p> <p>We believe the interpretation is unclear as to whether noncompliance or suspected noncompliance should be communicated to referred-to auditors. Moreover, we believe it is uncertain whether PEEC intends for:</p> <ol style="list-style-type: none"> 1. The language “components whose financial or other information is subject to procedures performed for purposes of the group audit engagement” in paragraph 23 of the interpretation to mean components that are audited by component auditors and referred-to auditors, or alternatively, only components that are audited by component auditors (as defined in the proposed SAS). 2. The language “those performing work at components” in paragraph 23 of the interpretation to mean component auditors and referred-to auditors, or alternatively, only component auditors (as defined in the proposed SAS). 	

Overall Opinion	Commenter	Comment	Response to Comment
		<p>Accordingly, we question whether the guidance in the proposed SAS in paragraph 96 that the group engagement partner may have an obligation to communicate noncompliance or suspected noncompliance to component auditors, but not to referred-to auditors, is correct.</p> <p>It is our belief that this matter needs to be clarified by PEEC (including consideration as to whether amendments are necessary to clarify the interpretation with respect to referred-to auditors), such that the appropriate interpretation can then be included in the proposed SAS, as appropriate. Therefore, we recommend the ASB to engage with PEEC, as outlined below, to clarify PEEC's intention in the interpretation with respect to referred-to auditors:</p> <ol style="list-style-type: none"> 1. We recommend the ASB to confirm that PEEC has a clear understanding of the definitional changes in the proposed SAS (i.e., referred-to auditor and component auditor), including an understanding of the circumstances when the group engagement partner makes reference to the audit of a referred-to auditor in the auditor's report on the group financial statements. 2. We recommend the ASB to confirm whether it is PEEC's intention for noncompliance or suspected noncompliance to be communicated to (a) only component auditors or (b) both component auditors and referred-to auditors. 3. Based on PEEC's confirmed intention, we recommend the ASB to consider whether revisions to the proposed SAS are necessary to clarify the obligation (or lack thereof) to communicate noncompliance or suspected noncompliance to referred-to auditors in accordance with the interpretation. <p>While we recommend the ASB to engage with PEEC to resolve this matter, we acknowledge our belief that noncompliance or suspected noncompliance should be communicated to component auditors only and not also to referred-to auditors, given the nature of the group auditor and referred-to auditor's relationship.</p> <p>Relates to Request for Comment No. 6</p>	
	GAO	<p>Generally, one area that could be clarified relates to paragraph 60 of the proposed SAS regarding the group engagement partner determining whether to name a referred-to auditor, and to present the referred-to auditor's report, in the auditor's report on the group financial statements. This could be clarified by noting that this determination is a matter of professional judgment, including references to other relevant AU-C sections the group engagement partner should consider in making this determination.</p> <p>Relates to Request for Comment No. 1b</p>	

Overall Opinion	Commenter	Comment	Response to Comment
	GT	<p>We continue to have concerns about how the definition of engagement team in SAS 146 will be operationalized, particularly with regard to independence. While we understand this matter is currently with PEEC, it is imperative that the Board collaborate with PEEC as there are broader implications beyond referred-to auditors, as defined by US GAAS. With that in mind, we believe the Board has provided sufficient guidance in the proposed SAS to understand these terms.</p>	
	John Keyser	<p>Paragraph 37 implies that there would be a single level of component performance materiality that would be the same for every account balance and class of transactions audited by the component auditor. This seems inconsistent with the definition of performance materiality in AU-C 320 that require auditors to set multiple levels of performance materiality based on specific circumstances of the entity.</p> <p>Relates to Request for Comment No.1b</p> <p>Paragraph 39 appears to require the group auditor to determine, not only the scope of the audit work, but the specific audit procedures (i.e. “the nature, timing and extent of the work”) to be performed by the component auditor. In contrast, paragraph 44 requires the group auditor to evaluate the appropriateness of the design of the further audit procedures performed by the component auditor. Such an evaluation seems unnecessary if the group auditor is the one who designed the procedures in the first place pursuant to paragraph 39. The Board should clarify whether the group auditor must design the audit procedures or evaluate the procedures designed by the component auditor.</p>	
	NSAA	<p>We recommend clarifying, in paragraph 15, the type of auditor for which the objectives are outlined. In this paragraph, it appears to be the group auditor and if so, this should be noted.</p>	
	SL	<p>Can we ask for clarity, as it pertains to paragraph 60 of the proposed SAS. It refers to when naming referred-to auditor. This seems that it may allow for not referring to the referred-to auditor by name, but by concept. Would this clarify that the specific naming of a referred-to auditor, only require the inclusion of the referred-to auditor report.</p> <p>Relates to Request for Comment No.11</p>	
Early Implementation			
	EY	<p>We expect many firms will need to early adopt them to align with the adoption of ISA 600 (Revised) and the International Auditing and Assurance Standard Board’s suite of new and revised quality management standards. Thus, we strongly encourage the Board to develop transition guidance to help auditors that early adopt the guidance.</p> <p>Implementation of this proposal would require significant effort, including potential discussions across global networks. It would also require early communication and planning with group management and those charged with governance of the group. Implementing a risk-based approach for a group audit would be particularly challenging for initial audits.</p>	

Overall Opinion	Commenter	Comment	Response to Comment
		Relates to Request for Comment No.13	
	KPMG	<p>We understand that consistent with the Board’s drafting conventions, early adoption of the proposed SAS is permitted when there is no explicit language that states otherwise. As a global network firm, the ability to early adopt the proposed SAS will be critical as we implement ISA 600 [Revised] with an effective date for audits of group financial statements for periods beginning on or after December 15, 2023.</p> <p>Relates to Request for Comment No.13</p>	
	RSM	<p>We note that International Standards on Auditing (ISA) 600 (revised), <i>Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)</i>, is effective for audits of financial statements for periods beginning on or after December 15, 2023, which is prior to the effective date for the proposed SAS. Because several firms have global audit methodologies and because the proposed SAS substantially converges with ISA 600, it would be helpful if the proposed SAS provided for early adoption.</p> <p>Relates to Request for Comment No.13</p>	
	OSCPA	<p>Some of the concepts in the standard would be good current guidance, and perhaps application materials could point to concepts that can be implemented immediately.</p> <p>Relates to Request for Comment No.13</p>	
	TXCPA	<p>No indication was given on whether or not early implementation of the proposed SAS is allowed.</p> <p>Relates to Request for Comment No.13</p>	
Changes to Other AU-C Sections			
	GT	<p>We support the proposed requirement being added to AU-C section 935 regarding the use of other auditors in a compliance audit.</p> <p>In considering the proposed changes to paragraph 78 of AU-C section 940, we noted a reference to the “auditor’s report on the group financial statements” (in the fifth line down as presented in the proposed SAS), which we believe should refer to the “auditor’s report on ICFR” instead.</p>	
	RSM	<p>We submit the following comments related to certain of the proposed amendments to the other AU-C sections:</p> <ul style="list-style-type: none"> • Because the proposed changes to paragraph A31 of AU-C Section 550, <i>Related Parties</i>, discuss the communications that apply to group audits, particularly those that involve component auditors or when reference is made to referred-to auditors, we suggest that it would be helpful if paragraph A31 included a footnote that references paragraphs 33b, 34b, 62b and 62d(ii) of proposed AU-C Section 600. 	

Overall Opinion	Commenter	Comment	Response to Comment
		<p>We note that as proposed, paragraph .02 of AU-C Section 805, <i>Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement</i>, would cause AU-C Section 805 to not apply to circumstances in which audit procedures are performed by a component auditor. We believe Section 805 also should not apply to the audit of the referred-to auditor. Therefore, we suggest that proposed paragraph .02 of AU-C Section 805 be revised as follows (our proposed additions are noted in bold font):</p> <p>.02 This section does not apply to (a) circumstances in which the audit procedures are performed by a component auditor on the financial information of a component for purposes of an audit of group financial statements, or (b) the report of a referred-to auditor issued as a result of work performed on the financial information of a component for purposes of an audit of group financial statements (see proposed Statement on Auditing Standards <i>Special Considerations — Audits of Group Financial Statements [Including the Work of Component Auditors and Audits of Referred-to Auditors]</i>).</p> <ul style="list-style-type: none"> • We suggest the following additional clarifying revision to paragraph 79.a. of AU-C Section 940, <i>An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements</i>, (our proposed addition is noted in bold font): • <ul style="list-style-type: none"> a. the group engagement partner has determined that the referred-to auditor has performed an audit of the component’s ICFR in accordance with the relevant requirements of GAAS (or, if applicable, the standards promulgated by the PCAOB) 	

EXPOSURE DRAFT

PROPOSED STATEMENT ON AUDITING STANDARDS

SPECIAL CONSIDERATIONS — AUDITS OF GROUP FINANCIAL STATEMENTS (INCLUDING THE WORK OF COMPONENT AUDITORS AND AUDITS OF REFERRED-TO AUDITORS)

Supersedes Statement on Auditing Standards [SAS] No. 122, Statements on Auditing Standards: Clarification and Recodification, as amended, section 600, Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors) [AICPA, Professional Standards, AU-C sec. 600];

Amends SAS No. 117, Compliance Audits, as Amended (AICPA, Professional Standards, AU-C Section 935)

Amends the following sections of SAS No. 122, as amended

- Section 230, Audit Documentation (AICPA, Professional Standards, AU-C sec. 230)*
- Section 260, The Auditor’s Communication With Those Charged With Governance (AICPA, Professional Standards, AU-C sec. 260)*
- Section 300, Planning an Audit (AICPA, Professional Standards, AU-C sec. 300)*
- Section 320, Materiality in Planning and Performing an Audit (AICPA, Professional Standards, AU-C sec. 320)*
- Section 402, Audit Considerations Relating to an Entity Using a Service Organization (AICPA, Professional Standards, AU-C sec. 402)*
- Section 450, Evaluation of Misstatements Identified During the Audit (AICPA, Professional Standards, AU-C sec. 450)*
- Section 501, Audit Evidence — Specific Considerations for Selected Items (AICPA, Professional Standards, AU-C sec. 501)*
- Section 510, Opening Balances — Initial Audit Engagements, Including Reaudit Engagements (AICPA, Professional Standards, AU-C sec. 510)*
- Section 550, Related Parties (AICPA, Professional Standards, AU-C sec. 550)*
- Section 805, Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement (AICPA, Professional Standards, AU-C sec. 805)*

- ***Section 920, Letters for Underwriters and Certain Other Requesting Parties (AICPA, Professional Standards, AU-C sec. 920)***
- ***Section 930, Interim Financial Information (AICPA, Professional Standards, AU-C sec. 930)***

Amends SAS No. 128, *Using the Work of Internal Auditors* (AICPA, Professional Standards, AU-C sec. 610)

Amends SAS No. 130, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*, as Amended (AICPA, Professional Standards, AU-C sec. 940)

Amends SAS No. 134, *Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements*, as Amended, *Section 700, Forming an Opinion and Reporting on Financial Statements*, *Section 701, Communicating Key Audit Matters in the Independent Auditor’s Report*, and *Section 705, Modification to the Opinion in the Independent Auditor’s Report* (AICPA, Professional Standards, AU-C sec. 700, 701, and 705)

Amends SAS No. 137, *The Auditor’s Responsibilities Relating to Other Information Included in Annual Reports*, as Amended (AICPA, Professional Standards, AU-C sec. 720)

Amends SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, as Amended (AICPA, Professional Standards, AU-C sec. 315)

Amends Statement on Standards for Attestation Engagements (SSAE) No. 18, *Attestation Standards: Clarification and Recodification*, as Amended (AICPA, Professional Standards, AT-C sec. 105)

Amends Proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*

Amends Proposed Statement on Quality Management Standards (SQMS) No. 1, *A Firm’s System of Quality Management*

Amends Proposed SQMS No. 2, *Engagement Quality Reviews*

March 23, 2022

Comments are requested by June 21, 2022

Prepared by the AICPA Auditing Standards Board for comment from persons interested in auditing and reporting issues.

Comments should be addressed to CommentLetters@aicpa-cima.com



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Explanatory Memorandum

Introduction

This memorandum provides background to the proposed Statement on Auditing Standard (SAS) *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)* (hereinafter referred to as *the proposed SAS* for purposes of this memorandum). If issued as final, the proposed SAS will supersede SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification*, as amended, section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*. The proposed SAS would also amend the following SASs:

- SAS No. 117, *Compliance Audits*, as Amended (AU-C section 935)

- SAS No. 122, as amended
 - section 230, *Audit Documentation* (AU-C sec. 230)
 - section 260, *The Auditor's Communication With Those Charged With Governance* (AU-C sec. 260)
 - section 300, *Planning an Audit* (AU-C sec. 300)
 - section 402 *Audit Considerations Relating to an Entity Using a Service Organization* (AU-C sec. 402)
 - section 450, *Evaluation of Misstatements Identified During the Audit* (AU-C sec. 450)
 - section 501, *Audit Evidence — Specific Considerations for Selected Items* (AU-C sec. 501)
 - section 510 *Opening Balances — Initial Audit Engagements, Including Reaudit Engagements* (AU-C sec. 510)
 - section 550, *Related Parties* (AU-C sec. 550)
 - section 805, *Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement* (AU-C sec. 805)
 - section 930, *Interim Financial Information* (AU-C sec. 930)

- SAS No. 128, *Using the Work of Internal Auditors* (AU-C sec. 610)

- SAS No. 130, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*, as Amended (AU-C sec. 940)

- SAS No. 134, *Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements*, as amended
 - section 700, *Forming an Opinion and Reporting on Financial Statements* (AU-C section 700)
 - section 701, *Communicating Key Audit Matters in the Independent Auditor's Report* (AU-C sec. 701)
 - section 705 *Modification to the Opinion in the Independent Auditor's Report* (AU-C sec. 705)

- SAS No. 137, *The Auditor’s Responsibilities Relating to Other Information Included in Annual Reports, as Amended* (AU-C sec. 720)
- SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement, as Amended* (AU-C sec. 315)
- Statement on Standards for Attestation Engagements (SSAE) No. 18, *Attestation Standards: Clarification and Recodification, as Amended* (AT-C sec. 105)
- Proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards**
- Proposed Statement on Quality Management Standards (SQMS) No. 1, *A Firm’s System of Quality Management*†
- Proposed SQMS No. 2, *Engagement Quality Reviews*‡

Background

The Mission of the Auditing Standards Board

The mission of the Auditing Standards Board (ASB) is to serve the public interest by developing, updating, and communicating comprehensive standards and practice guidance that enable practitioners to provide high-quality, objective audit and attestation services to nonissuers in an effective and efficient manner. The ASB accomplishes this mission in part by developing auditing, attestation, and quality control standards that inspire public trust in the profession. In developing and updating auditing standards, the ASB considers the standards of other standard-setters, such as the International Auditing and Assurance Standards Board (IAASB), the Public Company Accounting Oversight Board (PCAOB), and the Government Accountability Office (GAO).

Why the ASB Has Developed This Proposed SAS

* Proposed Statement on Auditing Standards (SAS), *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, is expected to be issued as a final SAS in 2022 and codified as AU-C section 220 of AICPA *Professional Standards*. The content of the paragraphs in the proposed SAS that are shown in this exposure draft may change by the time the proposed SAS is issued as a final SAS.

† Proposed Statement on Quality Management Standards (SQMS) No. 1, *A Firm’s System of Quality Management*, is expected to be issued as a final SQMS in 2022 and codified as QM section 10 of AICPA *Professional Standards*. The content of the paragraphs in proposed SQMS No. 1 that are shown in this exposure draft may change by the time the proposed SQMS is issued as a final SQMS.

‡ Proposed SQMS No. 2, *Engagement Quality Reviews*, is expected to be issued as a final SQMS in 2022 and codified as QM section 20 of AICPA *Professional Standards*. The content of the paragraphs in SQMS No. 2 that are shown here may change by the time the proposed SQMS is issued as a final SQMS.

The ASB has developed this proposed SAS to strengthen the auditor’s approach to planning and performing a group audit and to improve the quality of group audits by doing the following:

- Clarifying and reinforcing that all applicable AU-C sections need to be applied in a group audit engagement. It does this by establishing stronger linkages to the other AU-C sections, in particular, to proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards* (proposed QM SAS); AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*; and AU-C section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.
- Including subsections in each section of the proposed SAS that describe the requirements that apply when component auditors are involved, helping to emphasize and clarify the interactions that are needed between the group auditor and component auditors, as well as helping to enhance the scalability of the proposed SAS (The proposed SAS notes that a referred-to auditor is not a component auditor).
- Providing greater clarity on the scope and applicability of the proposed SAS, including through enhancements to the definition of *group financial statements*.

The section of this exposure draft, “Fundamental Aspects of the Proposed Standard,” provides more information about the changes introduced by this proposed SAS.

Convergence

It is the ASB’s strategy to converge its standards with those of the IAASB, while taking into consideration the standards of other standard-setters. The ASB believes that it is particularly important to converge with International Standard on Auditing (ISA) 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* (ISA 600 [Revised]) for two primary reasons: First, the ASB believes that the issues that led the IAASB to revise its standards are of equally critical importance in the United States. Second, for firms that perform engagements in accordance with standards of the IAASB and the ASB, complying with fundamentally different group audit standards is not feasible.

In converging with the standards of the IAASB, the ASB uses the corresponding IAASB standard as the base in developing its standard. The ASB has made certain changes to the language of the IAASB standard to use terms or phrases that are more common in the United States and to tailor examples and guidance to the U.S. environment. Additionally, consistent with extant AU-C section 600, the ASB has allowed for making reference to another auditor in the auditor’s report on group financial statements. ISA 600 (Revised), like its predecessor, does not include an option for the group engagement partner to make reference because this is not allowed under the ISAs. However, the ASB believes that such changes will not create substantive differences in audit quality between the application of ISA 600 (Revised) and the application of the proposed SAS.

Group Audits Projects of Other Standard-Setters

The ASB has monitored the projects of the IAASB and the PCAOB that address group audits. In particular, the ASB followed the project of the IAASB to revise ISA 600. The ASB Group Audits Task Force was formed to consider the implications of the IAASB project for audits of group financial statements under generally accepted auditing standards (GAAS). In addition to submitting a comment letter to the IAASB on its exposure draft, the ASB provided input to the development of the IAASB standard through the involvement of U.S. participants on the IAASB Group Audits Task Force and feedback to the IAASB at various stages of drafting the proposed standard, including through U.S. representation on the IAASB. The IAASB approved ISA 600 (Revised) as a final standard in December 2021. The IAASB will formally release the standard after confirmation is received from the Public Interest Oversight Board (PIOB) that due process was followed. ISA 600 (Revised) will be effective for audits of group financial statements for periods beginning on or after December 15, 2023.

IAASB Group Audits Project

The IAASB identified the need to develop and revise ISA 600 through a number of information-gathering and outreach activities. These activities highlighted a number of critical issues (that, as noted previously, are also critical in the United States) including the following:

- Concerns about the scope and applicability of extant ISA 600, including the need for greater clarity about whether, how, and the extent to which ISA 600 applies in certain circumstances
- Inadequate consideration by the auditor of certain matters that may be relevant when deciding whether to accept or continue a group audit engagement
- Inadequate involvement of the group engagement team in assessing the risks of material misstatement at the group financial statement level and in designing and performing appropriate responses to assessed risks (this has been attributed to the fact that the scope of the work in extant ISA 600 focuses on the identification of components and the determination of their significance, rather than on assessing risk)
- Deficiencies in communication between component auditors and the group engagement team during the planning and performance of the group audit
- Variability in the application of the concepts of component materiality and component performance materiality in a group audit, in particular, in relation to the concept of aggregation risk
- The need for additional guidance on documentation related to
 - restrictions on access to people or information, and
 - the nature, timing, and extent of the group engagement team’s direction and supervision of component auditors and review of their work.

PCAOB Project: Supervision of Audits Involving Other Auditors

On September 28, 2021, the PCAOB issued [Release 2021-005](#), which requested comments on proposed amendments to its auditing standards related to the supervision of audits that involve accounting firms and individual accountants outside the accounting firm that issues the audit report (that is, group audits).¹ In developing its proposed SAS, the ASB considered the PCAOB's proposed amendments and noted the fundamental differences between the structure of the IAASB's and PCAOB's standards related to group audits. ISA 600 (Revised) and the proposed SAS contain all the requirements related to group audits in a single standard (that is, from acceptance and continuance to concluding and reporting, including how the other relevant AU-C sections should be applied in a group audit). In comparison, the PCAOB has several disaggregated standards that address requirements related to various aspects of a group audit. The following identifies those standards and briefly describes what the proposed amendments would do to PCAOB standards:

- Rescind AS 1205, *Part of the Audit Performed by Other Independent Auditors*, so that the lead auditor, instead of being able to use the “work and reports” of other auditors under AS 1205, would be required to
 - when assuming responsibility for the other auditors' work, supervise the other auditor under AS 1201, *Supervision of the Audit Engagement*, and
 - when dividing responsibility for the audit with a referred-to auditor, comply with a new proposed AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*.
- Amend AS 1201 to provide additional direction to the lead auditor on how to apply the principles-based provisions of the standard to the supervision of other auditors. Specifically, the lead auditor would be required to perform certain procedures to supervise other auditors' work. Notwithstanding the specificity of the new procedures, the engagement partner (whose firm is the lead auditor) would remain responsible for the supervision of the entire audit.
- Amend AS 2101, *Audit Planning*, to incorporate and update certain requirements from AS 1205 and amend certain existing requirements to specify that they be performed by the lead auditor. For example, the amendments would enhance the requirements related to the engagement partner's assessment of whether his or her firm performs sufficient work on the audit to warrant serving as lead auditor.
- Adopt a new standard, AS 1206, which would retain, with modifications, many of the current requirements in AS 1205 that apply when the lead auditor divides responsibility with the referred-to auditor and refers to the referred-to auditor's report in the lead auditor's report. The new standard also would establish certain new requirements.

¹ This release was a second supplemental request for comment on amendments that were first included in a 2016 proposing release and subsequently revised in a 2017 supplemental request for comment.

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

The PCAOB standards also allow the lead auditor to make reference to a referred-to auditor’s report in the lead auditor’s report, similar to what extant AU-C section 600 allows.

Effective Date

The proposed SAS would be effective for audits of group financial statements for periods ending on or after December 15, 2026.

Fundamental Aspects of the Proposed Standard

The following summarizes what the ASB believes are the fundamental aspects of the proposed SAS:

- Clarifies that all AU-C sections need to be applied in a group audit and establishes stronger links to the other AU-C sections, particularly the proposed QM SAS; AU-C section 230, *Audit Documentation*; AU-C section 300; AU-C section 315; and AU-C section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*. The requirements and application material in the proposed SAS build on, and are consistent with, the principles and requirements in those AU-C sections.
- Includes a subsection in each section of the proposed SAS that provides considerations for the group auditor when component auditors are involved and identifies those subsections as such. This provides scalability for circumstances in which the group auditor does not involve component auditors and makes it easier for the group auditor to identify which requirements apply and which do not.
- Clarifies the scope and applicability of extant AU-C section 600 (the entry point into the AU-C section) by
 - revising the definition of *group financial statements* as financial statements that include the financial information of more than one entity or business unit through a consolidation process.
 - clarifying that the consolidation process includes consolidation, proportionate consolidation, inclusion, or an equity method of accounting; the presentation in combined financial statements of the financial information of entities or

business units that are under common control or common management; and the aggregation of the financial information of entities or business units such as branches or divisions.

- Introduces a principles-based approach that is adaptable to a wide variety of circumstances and scalable for audits of groups of different complexity, for example by
 - focusing on identifying, assessing, and responding to the risks of material misstatement.
 - including separate sections throughout the proposed SAS to highlight the requirements and application material for circumstances when component auditors are involved or when reference is made to the audit of a referred-to auditor in the auditor’s report on the group financial statements.

Under the risk-based approach in the proposed SAS, there is no longer a requirement for the group auditor to identify significant components and audit those components. Rather, the group auditor determines an appropriate approach to obtain sufficient appropriate audit evidence to address assessed risks of material misstatement of the group financial statements, which may, and often will, involve audit procedures being performed at the component level.

- Establishes a framework for planning and performing a group audit engagement. The framework
 - emphasizes special considerations for establishing the overall group audit strategy and group audit plan and highlights the importance of involving component auditors throughout all phases of a group audit.
 - focuses the group auditor’s attention on identifying, assessing, and responding to the risks of material misstatement of the group financial statements and emphasizes the importance of designing and performing procedures that are appropriate to respond to those assessed risks of material misstatement.
- Enhances the documentation requirements and application material to emphasize the linkage to the requirements in AU-C section 230 and the documentation requirements in other relevant AU-C sections and to clarify what the group auditor may need to document in different situations, including when there are restrictions on access to component auditor audit documentation.
- Clarifies how to address restrictions on access to people and information in a group audit, including restrictions on access to component management, those charged with governance of the component, component auditors, or information at the components.
- Clarifies how the requirements in the proposed QM SAS apply to manage and achieve

audit quality in a group audit, including sufficient and appropriate resources to perform the engagement, and the direction and supervision of the engagement team and the review of their work.

- Emphasizes the importance of professional skepticism, including when
 - determining the direction, supervision, and review of the component auditor’s work, and
 - making the group auditor’s evaluation of whether sufficient appropriate audit evidence has been obtained (including from the work performed by component auditors or through making reference to the audit of a referred-to auditor in the auditor’s report on the group financial statements) to provide a basis for forming an opinion on the group financial statements.
- Strengthens and clarifies
 - communications between the group auditor and component auditors, emphasizing the importance of two-way communications.
 - various aspects of the group auditor’s interaction with component auditors, including communicating relevant ethical requirements, determining competence and capabilities of the component auditor, and determining the appropriate nature, timing, and extent of involvement by the group auditor in the work of the component auditor.
- Introduces the term *referred-to auditor* and includes all the paragraphs related to making reference to the audit of a referred-to auditor together in one section within the proposed SAS, located towards the end of the proposed SAS.

Request for Comment

1. With respect to the linkages to other AU-C sections

- a. does the proposed SAS have appropriate linkages to other AU-C sections and to the proposed SQMSs?
- b. does the proposed SAS sufficiently address the special considerations in a group audit as they relate to applying the requirements and application material in other relevant AU-C sections, including the proposed QM SAS? Are there other special considerations for a group audit that you believe have not been addressed in the proposed SAS?
- c. does the proposed SAS result in a group audit that achieves the objectives of the proposed QM SAS?

2. With respect to the structure of the proposed SAS, do you support the placement of subsections throughout the proposed SAS that highlight the requirements when component auditors are involved or when reference is made to the audit of a referred-to auditor in the auditor's report on the group financial statements?
3. Is the scope and applicability of the proposed SAS clear? In that regard, is the definition of *group financial statements*, including the linkage to a consolidation process, clear?
4. With respect to the scalability of the proposed SAS
 - a. do you believe the proposed SAS is scalable to groups of different sizes and complexities, recognizing that *group financial statements*, as defined in the proposed SAS, include the financial information of more than one entity or business unit? If not, what suggestions do you have for improving the scalability of the proposed SAS?
 - b. do you believe that the guidance in exhibit A, "Relevancy of Requirements in Various Group Audit Scenarios," of the proposed SAS is understandable and provides clarity on the relevancy of certain requirements of the proposed SAS in various group audit scenarios? Would the relevancy of certain requirements of the proposed SAS in various group audit scenarios be clear without exhibit A?
5. Do you support the enhanced requirements and application material on documentation, including the linkage to the requirements of AU-C section 230? In particular
 - a. are there specific matters that you believe should be documented other than those described in paragraph 76 of the proposed SAS?
 - b. do you agree with the application material in paragraphs A203–A219 of the proposed SAS relating to the group auditor's audit documentation?

Additional Matters for Consideration

Definitions: Referred-to Auditor, Component Auditor, Group Auditor, and Engagement Team

The proposed SAS does the following:

- Introduces the term *referred-to auditor*, which is defined as follows:

An auditor who performs an audit of the financial statements of a component to which the group engagement partner determines to make reference in the auditor's report on the group financial statements. A referred-to auditor is not a component auditor, and accordingly, is not a part of the engagement team for a group audit.

In extant AU-C section 600, an auditor for whom the group auditor assumes responsibility and an auditor to whom the group auditor makes reference are both termed *component*

auditors. A referred-to auditor in the proposed SAS is equivalent to a component auditor to whom the group auditor makes reference in extant AU-C section 600.

- Revises the definition of the term *component auditor* to indicate that a component auditor is part of the engagement team to reflect the following definition of the term *engagement team* in the proposed QM SAS:

All partners and staff performing the engagement, and any other individuals who perform procedures on the engagement, excluding an auditor's external specialist² and internal auditors who provide direct assistance on an engagement.

- Replaces the term *group engagement team*,³ used in extant AU-C section 600, with the term *group auditor* and the following definition of that term:

The group engagement partner and members of the engagement team other than component auditors. The group auditor is responsible for the following:

- i. Establishing the overall group audit strategy and group audit plan
- ii. Directing and supervising component auditors and reviewing their work
- iii. Evaluating the conclusions drawn from the audit evidence obtained as the basis for forming an opinion on the group financial statements

The definition of group auditor clarifies that component auditors are not included in that designation. For purposes of a group audit, it is necessary to carve out component auditors from the definition of group auditor because the group auditor (and not component auditors) are responsible for items i–iii in the definition of group auditor.

Request for Comment

6. Are the definitions of the terms *referred-to auditor*, *component auditor*, and *group auditor* clear, including as they relate to the definition of the term *engagement team* in the proposed QM SAS?

Engagement Partner Has Overall Responsibility for the Audit

Item 4 of appendix C, “Amendments to Various Statements on Auditing Standards (SASs), as Amended; to SSAE No. 18, *Attestation Standards: Clarification and Recodification, as Amended*; and to Proposed Statements on Quality Management Standards *Quality Management*,” of the proposed SAS would add the following paragraph to AU-C section 300 and make it applicable to all audit engagements:

² Paragraph .06 of AU-C section 620, *Using the Work of an Auditor's Specialist*, defines the term *auditor's specialist*.

³ The term *group engagement team* is defined as partners, including the group engagement partner, and staff who establish the overall group audit strategy, communicate with component auditors, perform work on the consolidation process, and evaluate the conclusions drawn from the audit evidence as the basis for forming an opinion on the group financial statements.

11. The engagement partner should review the overall audit strategy and audit plan.

The proposed QM SAS and the proposed SAS require the (group) engagement partner to take overall responsibility for managing and achieving quality on the (group) audit engagement. The addition of this requirement is intended to align the requirements in AU-C section 300 with the aforementioned requirements in the proposed QM SAS and the proposed SAS and to improve audit quality. The (group) engagement partner’s review of the overall audit strategy and audit plan demonstrates that the (group) engagement partner has overall responsibility for the (group) audit engagement.

Request for Comment

7. Is the requirement in paragraph 11 clear? Are there additional requirements or application material relating to paragraph 11 that are needed, and if so, what should they be?

Reports From Component Auditors Related to Reviews of Interim Financial Information of Components

The proposed SAS eliminates the concept of “significant components” and no longer includes a requirement for the group auditor to identify and audit significant components. Paragraph 14*b* of AU-C section 930, *Interim Financial Information*, includes a reference to significant components and requires the auditor, when conducting a review of interim financial information, to obtain reports from component auditors, if any, related to reviews performed of the interim financial information of significant components of the reporting entity, including its investees, or inquire of those auditors if reports have not been issued. Item 13 of appendix C of the proposed SAS deletes paragraph 14*b* and related application paragraph A17 of AU-C section 930.

Request for Comment

8. Do you agree with the deletion of this requirement and the related application paragraph? Do you have other suggestions for considering components in interim reviews now that the concept of “significant components” has been eliminated?

Equity Method Investments

Consistent with extant AU-C section 600, investments accounted for using the equity method (that is, EMIs) are considered components and therefore are subject to the scope of the proposed SAS. Currently, the proposed SAS includes application material related to EMIs in paragraphs A47–A49. Additionally, paragraph A10 provides guidance on how the group auditor may use the work of an audit that has already been completed, which sometimes occurs with EMIs; however, the requirements of the proposed SAS still apply.

Request for Comment

9. Do you agree with the application material in paragraphs A47–A49 of the proposed SAS relating to a noncontrolling interest in an entity that is accounted for by the equity method? Are there additional requirements or application material relating to EMIs that are needed in the proposed SAS, and if so, what should they be?

Referred-to Auditor Requirements

In extant AU-C section 600, the group engagement partner is responsible for deciding, individually for each component, to either

- assume responsibility for, and thus be required to be involved in, the work of a component auditor, insofar as that work relates to the expression of an opinion on the group financial statements, or
- not assume responsibility for, and accordingly make reference to, the audit of a component auditor in the auditor’s report on the group financial statements.

The option for the group engagement partner to make reference has been maintained in the proposed SAS. Additionally, the majority of the requirements related to making reference have been included in paragraphs .51–.65 of the proposed SAS, with additional clarifying guidance in exhibit A.

Request for Comment

10. Do you support retaining the option that exists in extant AU-C section 600 for the group engagement partner to make reference to the audit of a referred-to auditor (a component auditor per extant AU-C section 600) in the auditor’s report on the group financial statements?

11. Are the specific requirements relating to referred-to auditors clear, appropriate, and easily identifiable within the proposed SAS, including when considering exhibit A?

Determining Whether Sufficient Appropriate Audit Evidence Can Be Obtained When Making Reference to Referred-to Auditors

Paragraph A41 of the proposed SAS addresses engagement acceptance and continuance and the complexities of determining whether sufficient appropriate audit evidence can reasonably be expected to be obtained in a group audit in which reference is made to the audit of referred-to auditors in the auditor’s report on the group financial statements, including in group audits in which no component auditors are also involved. The last sentence of that paragraph states the following:

As the magnitude of the portion of the financial statements that is audited by referred-to auditors increases, it is less likely that the group engagement partner can conclude that

sufficient appropriate audit evidence can be obtained.

Request for Comment

12. Is the last sentence of paragraph A41 clear? Is there additional application material that is needed, and if so, what should it be?

Applicability of AU-C Section 600 to Compliance Audits

AU-C section 935, *Compliance Audits*, addresses the application of GAAS to a compliance audit. AU-C sections 200–900 address audits of financial statements as well as certain other kinds of engagements. Generally, these AU-C sections can be adapted to the objectives of a compliance audit. However, certain AU-C sections, or portions thereof, are not applicable to a compliance audit because (a) they are not relevant to a compliance audit environment; (b) the procedures and guidance would not contribute to meeting the objectives of a compliance audit; or (c) the subject matter is specifically covered in AU-C section 935. These AU-C sections, or specified requirements thereof, are identified in the appendix to AU-C section 935, “AU-C Sections That Are Not Applicable to Compliance Audits” (the appendix).

The proposed SAS is written in the context of group financial statements with a focus on a consolidation process and aggregation risk. The concepts therein are difficult to adapt and apply to a compliance audit due to the nature of that engagement, which differs from an audit of financial statements. Accordingly, the conforming amendments related to AU-C section 935 indicate that AU-C section 600 is not applicable to a compliance audit.

A proposed new requirement is being added to AU-C section 935 to address situations in which the auditor uses the work of another auditor. This requirement is similar to the requirement in extant paragraph .33 of AT-C section 105, *Concepts Common to All Attestation Engagements*, related to using the work of another practitioner, which applies to examinations of compliance that are required by a governmental audit requirement to be performed under the attestation standards. However, the proposed new requirement in AU-C section 935 uses language that is aligned with U.S. GAAS, particularly language within the proposed group audits SAS and the proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

Attestation Engagements Involving Another Practitioner

To be consistent with the language in the proposed new requirement in AU-C section 935, as described previously, similar conforming amendments are proposed to paragraph .33 of AT-C section 105.

Effective Date

If issued as final, the proposed SAS will be effective for audits of group financial statements for periods ending on or after December 15, 2026. Recognizing the interconnectivity of the proposed SAS with the proposed QM SAS, the ASB believes that this is an appropriate effective date for the proposed SAS as it is consistent with the effective date of the proposed QM SAS. The ASB welcomes comments on whether this would provide a sufficient period to support effective implementation of the proposed SAS.

Request for Comment

13. Does the proposed effective date provide sufficient time for preparers, auditors, and others to adopt the new standard and related conforming amendments, including sufficient time to support effective implementation of the proposed SAS?

Guide for Respondents

Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and, when appropriate, make specific suggestions for any proposed changes to wording. When a respondent agrees with proposals in the exposure draft, it will be helpful for the ASB to be made aware of this view, as well.

Written comments on this exposure draft will become part of the public record of the AICPA and will be available on the AICPA’s website after June 21, 2022, until a final standard is issued. Please send responses to CommentLetters@aicpa-cima.com by June 21, 2022.

Comment Period

The comment period for this exposure draft ends on June 21, 2022.

**Auditing Standards Board
(2021–2022)**

Tracy W. Harding, *Chair*
Brad C. Ames
Maxene Bardwell
Samantha Bowling
Patricia Bottomly
Sherry Chesser
Harry Cohen
Jeanne Dee
Horace Emery
Diane Hardesty

Robert Harris
Kathleen K. Healy
Jon Heath
Clay Huffman
Greg Jenkins
Sara Lord
Maria C. Manasses
Andrew Prather
Chris Rogers
Tania Desilva Sergott

Group Audits Task Force

Dora Burzenski, *Chair*
assisted by Lauren Kolarik
Mike Bingham
Monique Booker

Harry Cohen
Heather Funsch
Clay Huffman
Maria C. Manasses

AICPA Staff

Jennifer Burns <i>Chief Auditor</i> <i>Professional Standards and Services</i>	Judith Sherinsky <i>Senior Manager</i> <i>Audit and Attest Standards —Public Accounting</i>
Teighlor S. March <i>Assistant General Counsel —Office of General Counsel</i>	

PROPOSED STATEMENT ON AUDITING STANDARDS
*Audits of Group Financial Statements (Including the Work of Component
Auditors and Audits of Referred-to Auditors)*

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**Proposed Statement on Auditing Standards *Special Considerations — Audits of Group
Financial Statements (Including the Work of Component Auditors
and Audits of Referred-to Auditors)***

Introduction

Scope of This Proposed Statement on Auditing Standards

1. Generally accepted auditing standards (GAAS) apply to an audit of group financial statements (a group audit). This proposed Statement on Auditing Standards (SAS) applies to all group audits. It addresses special considerations that apply to a group audit, including in circumstances in which component auditors are involved or when the group auditor makes reference to the audit of a referred-to auditor. The requirements and guidance in this proposed SAS refer to, or expand on, the application of other relevant AU-C sections to a group audit, in particular, proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards* (proposed QM SAS); AU-C section 230, *Audit Documentation*;¹ AU-C section 300, *Planning an Audit*; AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*; and AU-C section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*. (Ref: par. 0–0)
2. Group financial statements include the financial information of more than one entity or business unit through a consolidation process, as described in paragraph 0. The term *consolidation process* as used in this proposed SAS refers not only to the preparation of consolidated financial statements in accordance with the applicable financial reporting framework but also to the presentation of combined financial statements and to the aggregation of the financial information of entities or business units, such as branches or divisions. (Ref: par. 0–0, 0)
3. Government entities frequently prepare group financial statements. The AICPA Audit and Accounting Guide *State and Local Governments* provides guidance to assist auditors in auditing and reporting on those financial statements in accordance with GAAS, including the requirements of this section.
4. As explained in the proposed QM SAS,² this proposed SAS, adapted as necessary in the circumstances, may also be useful in an audit of financial statements other than a group audit when the engagement team includes individuals from another firm. For example, this proposed SAS may be useful when involving such an individual to attend a physical inventory count; inspect property, plant, and equipment; or perform audit procedures at a shared service center at a remote location.

Groups and Components

¹ All AU-C sections can be found in AICPA *Professional Standards*.

² Paragraph A1 of proposed Statement on Quality Management Standards *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards* (QM SAS).

5. A group may be organized in various ways. For example, a group may be organized by legal or other entities, such as a parent and one or more subsidiaries, joint ventures, or investments accounted for by the equity method. Alternatively, the group may be organized by geography, by other economic units (including branches or divisions), or by functions or business activities. In this proposed SAS, these different forms of organization are collectively referred to as *entities* or *business units*. (Ref: par. 0)
6. The group auditor determines an appropriate approach to planning and performing audit procedures to respond to the assessed risks of material misstatement of the group financial statements. For this purpose, the group auditor uses professional judgment in determining the components at which audit work will be performed. This determination is based on the group auditor's understanding of the group and its environment, and other factors such as the ability to perform audit procedures centrally, the presence of shared service centers, or the existence of common information systems and controls. (Ref: par. 0–0)

Involvement of Component Auditors

7. The proposed QM SAS³ requires the engagement partner to determine that sufficient and appropriate resources to perform the engagement are assigned or made available to the engagement team in a timely manner. In a group audit, such resources may include component auditors, who are a part of the engagement team. Therefore, this proposed SAS requires the group auditor to determine the nature, timing, and extent of involvement of component auditors.
8. The group auditor may involve component auditors to provide information, or to perform audit work, to fulfill the requirements of this proposed SAS. Component auditors may have greater experience with and a more in-depth knowledge of the components and their environments (including local laws and regulations, business practices, language, and culture) than the group auditor. Accordingly, component auditors can be, and often are, involved in all phases of the group audit. (Ref: par. 0–0)
9. Audit risk is a function of the risks of material misstatement and detection risk.⁴ Detection risk in a group audit includes the risk that a component auditor may not detect a misstatement in the financial information of a component that could cause a material misstatement of the group financial statements, and that the group auditor may not detect this misstatement. Accordingly, this proposed SAS requires sufficient and appropriate involvement by the group engagement partner or group auditor, as applicable, in the work of component auditors and emphasizes the importance of two-way communication between the group auditor and component auditors. In addition, this proposed SAS explains the matters that the group auditor takes into account when determining the nature, timing, and extent of the direction and supervision of component auditors and the review of their work. (Ref: par. 0–0)

³ Paragraph 25 of the proposed QM SAS.

⁴ Paragraph .A36 of AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

Making Reference to the Audit of a Referred-to Auditor

10. This proposed SAS also describes the procedures to be followed to obtain sufficient appropriate audit evidence when the group engagement partner determines to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements. A referred-to auditor is not a component auditor, and accordingly, a referred-to auditor is not a part of the engagement team. Therefore, when the terms *component auditor* and *engagement team* are used in this proposed SAS, they do not include referred-to auditors. Reference in the auditor's report on the group financial statements to the fact that part of the audit was conducted by a referred-to auditor communicates the source of audit evidence with respect to those components for which such reference is made. The requirements in paragraphs 00 and the related application material are specific to referred-to auditors. Therefore, when the group engagement partner plans to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements, these requirements, in addition to other requirements, are relevant.

Professional Skepticism

11. In accordance with AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*,⁵ the engagement team is required to plan and perform the group audit with professional skepticism and to exercise professional judgment. The appropriate maintenance of professional skepticism may be demonstrated through the actions and communications of the engagement team, including emphasizing the importance of each engagement team member maintaining professional skepticism throughout the group audit. Such actions and communications may include specific steps to mitigate impediments that may impair the appropriate maintenance of professional skepticism. (Ref: par. 0–0)

Scalability

12. This proposed SAS applies to all group audits, regardless of size or complexity. However, the requirements of this proposed SAS are intended to be applied in the context of the nature and circumstances of each group audit. For example, when a group audit is carried out entirely by the group auditor, some requirements in this proposed SAS are not relevant because they are conditional on the involvement of component auditors or on making reference to the audit of a referred-to auditor in the auditor's report on the group financial statements. This may be the case when the group auditor is able to perform audit procedures centrally or when the group auditor is able to perform procedures at the components without involving component auditors or making reference to the audit of a referred-to auditor in the auditor's report on the group financial statements. The guidance in paragraphs 0 and 0 also may be helpful in applying this proposed SAS in these circumstances. (Ref: Exhibit A, "Relevancy of Requirements in Various Group Audit Scenarios")

⁵ Paragraphs .17–.18 and .A22–.A28 of AU-C section 200.

Responsibilities of the Group Engagement Partner and Group Auditor

13. The group engagement partner remains ultimately responsible, and therefore accountable, for compliance with the requirements of this proposed SAS. The phrase “the group engagement partner should take responsibility for...” or “the group auditor should take responsibility for...” is used for those requirements when the group engagement partner or group auditor, respectively, is permitted to assign the design or performance of procedures, tasks, or actions to other appropriately skilled or suitably experienced members of the engagement team, including component auditors. For other requirements, this proposed SAS expressly intends that the requirement or responsibility be fulfilled by the group engagement partner or group auditor, as applicable, and the group engagement partner or group auditor may obtain information from the firm or other members of the engagement team. (Ref: par. 0, 0)

Effective Date

14. This proposed SAS is effective for audits of group financial statements for periods ending on or after December 15, 2026.

Objectives

15. The objectives of the auditor are to do the following:
 - a. With respect to the acceptance and continuance of the group audit engagement, determine whether sufficient appropriate audit evidence can reasonably be expected to be obtained to provide a basis for forming an opinion on the group financial statements
 - b. Identify and assess the risks of material misstatement of the group financial statements, whether due to fraud or error, and plan and perform further audit procedures to appropriately respond to those assessed risks
 - c. Be sufficiently and appropriately involved in the work of component auditors throughout the group audit, including communicating clearly about the scope and timing of their work, and evaluating the results of that work
 - d. Evaluate whether sufficient appropriate audit evidence has been obtained from the audit procedures performed, including with respect to the work performed by component auditors, or through making reference to the audit of a referred-to auditor in the auditor’s report on the group financial statements, as a basis for forming an opinion on the group financial statements

Definitions

16. For purposes of GAAS, the following terms have the meanings attributed as follows:

aggregation risk. The probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole. (Ref: par. 0)

component. An entity, business unit, function or business activity, or some combination thereof, determined by the group auditor for purposes of planning and performing audit procedures in a group audit. (Ref: par. 0–0)

component auditor. An auditor who performs audit work related to a component for purposes of the group audit. A component auditor is a part of the engagement team⁶ for a group audit. (Ref: par. 0–0)

component management. Management responsible for a component. (Ref: par. 0)

component performance materiality. An amount set by the group auditor to reduce aggregation risk to an appropriately low level for purposes of planning and performing audit procedures in relation to a component.

group. A reporting entity for which group financial statements are prepared.

group audit. The audit of group financial statements.

group auditor. The group engagement partner and members of the engagement team other than component auditors. The group auditor is responsible for the following:

- i. Establishing the overall group audit strategy and group audit plan
- ii. Directing and supervising component auditors and reviewing their work
- iii. Evaluating the conclusions drawn from the audit evidence obtained as the basis for forming an opinion on the group financial statements

group audit opinion. The audit opinion on the group financial statements.

group engagement partner. The engagement partner⁷ responsible for the group audit. (Ref: par. 0)

group financial statements. Financial statements that include the financial information of more than one entity or business unit through a consolidation process. For purposes of this proposed SAS, a consolidation process includes one or more of the following: (Ref: par. 0–0)

- i. Consolidation, proportionate consolidation, inclusion, or an equity method of accounting

⁶ Paragraph 12 of proposed QM SAS.

⁷ Paragraph 12 of the proposed QM SAS.

- ii. The presentation in combined financial statements of the financial information of entities or business units that are under common control or common management
- iii. The aggregation of the financial information of entities or business units such as branches or divisions

group management. Management responsible for the preparation of the group financial statements.

group performance materiality. Performance materiality⁸ in relation to the group financial statements as a whole, as determined by the group auditor.

referred-to auditor. An auditor who performs an audit of the financial statements of a component to which the group engagement partner determines to make reference in the auditor’s report on the group financial statements. A referred-to auditor is not a component auditor, and accordingly, is not a part of the engagement team for a group audit.

17. Reference in this proposed SAS to “the applicable financial reporting framework” means the financial reporting framework that applies to the group financial statements. (Ref: par. 0)

Requirements

Leadership Responsibilities for Managing and Achieving Quality on a Group Audit

18. In applying the proposed QM SAS,⁹ the group engagement partner is required to take overall responsibility for managing and achieving quality on the group audit engagement. In doing so, the group engagement partner should do the following: (Ref: par. 0–0)
- a. Take responsibility for creating an environment for the group audit engagement that emphasizes the expected behavior of engagement team members (Ref: par. 0)
 - b. Be sufficiently and appropriately involved throughout the group audit engagement, including in the work of component auditors, such that the group engagement partner has the basis for determining whether the significant judgments made, and the conclusions reached, are appropriate given the nature and circumstances of the group audit engagement

Acceptance and Continuance

19. Before accepting or continuing the group audit engagement, the group engagement partner should determine whether sufficient appropriate audit evidence can reasonably be expected to be obtained (including through involving component auditors or through making

⁸ Paragraphs .09 and .11 of AU-C section 320, *Materiality in Planning and Performing an Audit*.

⁹ Paragraph 13 of the proposed QM SAS.

reference to the audit of a referred-to auditor in the auditor's report on the group financial statements) to provide a basis for forming an opinion on the group financial statements. (Ref: par. 0–0)

- 20.** If after the acceptance or continuance of the group audit engagement the group engagement partner concludes that sufficient appropriate audit evidence cannot be obtained, the group engagement partner should consider the possible effects on the group audit. (Ref: par. 0)

Terms of Engagement

- 21.** In applying AU-C section 210, *Terms of Engagement*,¹⁰ the group auditor should obtain the agreement of group management that it acknowledges and understands its responsibility to provide the engagement team with the following: (Ref: par. 0)
- a.* Access to all information of which group management is aware that is relevant to the preparation of the group financial statements such as records, documentation, and other matters
 - b.* Additional information that the engagement team may request from group management or component management for the purpose of the group audit
 - c.* Unrestricted access to persons within the group from whom the engagement team determines it necessary to obtain audit evidence

Restrictions on Access to Information or People Outside the Control of Group Management

- 22.** If the group engagement partner concludes that group management cannot provide the engagement team with access to information or unrestricted access to persons within the group due to restrictions that are outside the control of group management, the group engagement partner should consider the possible effects on the group audit. (Ref: par. 0–0)

Restrictions on Access to Information or People Imposed by Group Management

- 23.** If the group engagement partner concludes that (Ref: par. 0–0)
- a.* it will not be possible for the group auditor to obtain sufficient appropriate audit evidence due to restrictions imposed by group management; and
 - b.* the possible effect of this limitation will result in a disclaimer of opinion on the group financial statements, the group engagement partner should either
 - i.* in the case of an initial engagement, not accept the engagement, or, in the case of a recurring engagement, withdraw from the engagement, when

¹⁰ Paragraphs .06b and .08b of AU-C section 210, *Terms of Engagement*.

withdrawal is possible under applicable law or regulation, or

- ii. when the entity is required by law or regulation to have an audit, having performed the audit of the group financial statements to the extent possible, disclaim an opinion on the group financial statements.

Overall Group Audit Strategy and Group Audit Plan

24. In applying AU-C section 300,¹¹ the group auditor should establish, and update as necessary, an overall group audit strategy and group audit plan. In doing so, the group auditor should determine the following: (Ref: par. 0–0)
 - a. The components at which audit work will be performed (Ref: par. 0–0)
 - b. The resources needed to perform the group audit engagement, including the nature, timing, and extent to which component auditors are to be involved (Ref: par. 0–0)
 - c. The components for which, if any, the auditor’s report on the group financial statements will make reference to the audit of a referred-to auditor (see paragraphs 0–0).

Considerations When Component Auditors Are Involved

25. In establishing the overall group audit strategy and group audit plan, the group engagement partner should evaluate whether the group auditor will be able to be sufficiently and appropriately involved in the work of the component auditor. (Ref: par. 0)
26. As part of the evaluation in paragraph 0, the group auditor should request the component auditor to confirm that the component auditor will cooperate with the group auditor, including whether the component auditor will perform the work requested by the group auditor. (Ref: par. 0)

Relevant Ethical Requirements, Including Those Related to Independence

27. In applying the proposed QM SAS,¹² the group engagement partner should take responsibility for the following: (Ref: par. 0–0, 0)
 - a. Component auditors having been made aware of relevant ethical requirements that are applicable given the nature and circumstances of the group audit engagement
 - b. Confirming whether the component auditors understand and will comply with the

¹¹ Paragraphs .07–.10 of AU-C section 300.

¹² Paragraph 17 of the proposed QM SAS.

relevant ethical requirements, including those related to independence, that apply to the group audit engagement.

Engagement Resources

- 28.** In applying the proposed QM SAS,¹³ the group engagement partner should do the following: (Ref: par. 0–0)
- a.* Determine that component auditors have the appropriate competence and capabilities, including sufficient time, to perform the assigned audit procedures at the component
 - b.* If information about the results of the monitoring and remediation process or external inspections related to the component auditor has been provided by the group auditor’s firm or has otherwise been made available to the group engagement partner, determine the relevance of such information to the group auditor’s determination in paragraph 0*a*
- 29.** The group auditor should obtain sufficient appropriate audit evidence relating to the work to be performed at the component without involving the component auditor if
- a.* the component auditor does not comply with the relevant ethical requirements, including those related to independence, that apply to the group audit engagement,¹⁴ or (Ref: par. 0–0)
 - b.* the group engagement partner has serious concerns about the matters in paragraphs 00. (Ref: par. 0)

Engagement Performance

- 30.** In applying the proposed QM SAS,¹⁵ the group engagement partner should take responsibility for the nature, timing, and extent of direction and supervision of component auditors and the review of their work, taking into account the following: (Ref: par. 0–0)
- a.* Areas of higher assessed risks of material misstatement of the group financial statements or significant risks identified in accordance with AU-C section 315
 - b.* Areas in the audit of the group financial statements that involve significant judgment

Communications With Component Auditors

- 31.** The group auditor should communicate with component auditors about their respective

¹³ Paragraphs 25–26 of the proposed QM SAS.

¹⁴ Paragraphs .15–.16 of AU-C section 200.

¹⁵ Paragraph 29 of the proposed QM SAS.

responsibilities and the group auditor's expectations, including an expectation that communications between the group auditor and component auditors take place at appropriate times throughout the group audit. (Ref: par. 0–0)

Understanding the Group and Its Environment, the Applicable Financial Reporting Framework, and the Group's System of Internal Control

- 32.** In applying AU-C section 315,¹⁶ the group auditor should take responsibility for obtaining an understanding of the following: (Ref: par. 0–0)
- a. The group and its environment, including (Ref: par. 0–0)
 - i. the group's organizational structure and its business model, including
 - (1) the locations in which the group has its operations or activities,
 - (2) the nature of the group's operations or activities and the extent to which they are similar across the group, and
 - (3) the extent to which the group's business model integrates the use of IT;
 - ii. regulatory factors affecting the entities and business units in the group; and
 - iii. the measures used internally and externally to assess the entities or business units' financial performance
 - b. The applicable financial reporting framework and the consistency of accounting policies and practices across the group
 - c. The group's system of internal control, including
 - i. the nature and extent of commonality of controls, (Ref: par. 0–0, 0)
 - ii. whether, and if so, how, the group centralizes activities relevant to financial reporting, (Ref: par. 0–0)
 - iii. the consolidation process used by the group, including sub-consolidations, if any, and consolidation adjustments, and
 - iv. how group management communicates significant matters that support the preparation of the group financial statements and related financial reporting responsibilities in the information system and other components of the group's system of internal control to management of entities or business units (Ref: par. 0–0)

¹⁶ Paragraphs .19–.31 of AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

Considerations When Component Auditors Are Involved

- 33.** The group auditor should communicate the following to component auditors on a timely basis: (Ref: par. 0)
- a. Matters that the group auditor determines to be relevant to the component auditor's design or performance of risk assessment procedures for purposes of the group audit, including identified significant risks of the group financial statements
 - b. In applying AU-C section 550, *Related Parties*,¹⁷ related party relationships or transactions identified by group management, and any other related parties of which the group auditor is aware, that are relevant to the work of the component auditor (Ref: par. 0–0)
 - c. In applying AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, events or conditions identified by group management or the group auditor, that may raise substantial doubt about the group's ability to continue as a going concern for a reasonable period of time that are relevant to the work of the component auditor
- 34.** The group auditor should request component auditors to communicate the following on a timely basis:
- a. Matters related to the financial information of the component that the component auditor determines to be relevant to the identification and assessment of the risks of material misstatement of the group financial statements, whether due to fraud or error
 - b. Related party relationships not previously identified by group management or the group auditor (Ref: par. 0)
 - c. Any events or conditions identified by the component auditor that may raise substantial doubt about the group's ability to continue as a going concern for a reasonable period of time

Identifying and Assessing the Risks of Material Misstatement

- 35.** In applying AU-C section 315,¹⁸ based on the understanding obtained in paragraph 0, the group auditor should take responsibility for the identification and assessment of the risks of material misstatement of the group financial statements, including with respect to the consolidation process. (Ref: par. 0–0)

Considerations When Component Auditors Are Involved

¹⁷ Paragraph .19 of AU-C section 550, *Related Parties*.

¹⁸ Paragraphs .32–.38 of AU-C section 315.

36. In applying AU-C section 315,¹⁹ the group auditor should evaluate whether the audit evidence obtained from the risk assessment procedures performed by the group auditor and component auditors provides an appropriate basis for the identification and assessment of the risks of material misstatement of the group financial statements. (Ref: par. 0–0)

Materiality

37. In applying AU-C section 320, *Materiality in Planning and Performing an Audit*,²⁰ and AU-C section 450, *Evaluation of Misstatements Identified During the Audit*,²¹ when classes of transactions, account balances, or disclosures in the group financial statements are disaggregated across components, for purposes of planning and performing audit procedures, for those components on which the group auditor or component auditor will perform audit procedures, the group auditor should determine the following:
- a. Component performance materiality. To address aggregation risk, such amount should be lower than group performance materiality. (Ref: par. 0–0)
 - b. The threshold above which misstatements identified in the component financial information are to be communicated to the group auditor. Such threshold should not exceed the amount regarded as clearly trivial to the group financial statements. (Ref: par. 0)

Considerations When Component Auditors Are Involved

38. The group auditor should communicate to the component auditor the amounts determined in accordance with paragraph 0. (Ref: par. 0–0)

Responding to the Assessed Risks of Material Misstatement

39. In applying AU-C section 330,²² the group auditor should take responsibility for the nature, timing, and extent of further audit procedures to be performed, including determining the components at which to perform further audit procedures and the nature, timing, and extent of the work to be performed at those components. (Ref: par. 0–0)

Consolidation Process

40. The group auditor should take responsibility for designing and performing further audit procedures to respond to the assessed risks of material misstatement of the group financial statements arising from the consolidation process. This should include the following: (Ref: par. 0)

¹⁹ Paragraph .39 of AU-C section 315.

²⁰ Paragraph .11 of AU-C section 320.

²¹ Paragraph .05 of AU-C section 450, *Evaluation of Misstatements Identified During the Audit*.

²² Paragraphs .06–.07 of AU-C section 330.

- a. Evaluating whether all entities and business units have been included in the group financial statements as required by the applicable financial reporting framework and, if applicable, for designing and performing further audit procedures on sub-consolidations
 - b. Evaluating the appropriateness, completeness, and accuracy of consolidation adjustments and reclassifications (Ref: par. 0)
 - c. Evaluating whether management’s judgments made in the consolidation process give rise to indicators of possible management bias
 - d. Responding to assessed risks of material misstatement due to fraud arising from the consolidation process
41. If the financial information of an entity or business unit has not been prepared in accordance with the same accounting policies applied to the group financial statements, the group auditor should evaluate whether the financial information has been appropriately adjusted for purposes of the preparation and fair presentation of the group financial statements in accordance with the applicable financial reporting framework.
42. If the group financial statements include the financial information of an entity or business unit with a financial reporting period-end that differs from that of the group, the group auditor should take responsibility for evaluating whether appropriate adjustments have been made to that financial information in accordance with the applicable financial reporting framework.²³

Considerations When Component Auditors Are Involved

43. When the group auditor involves component auditors in the design or performance of further audit procedures, the group auditor should communicate with the component auditor about matters that the group auditor or component auditor determine to be relevant to the design of responses to the assessed risks of material misstatement of the group financial statements.
44. For areas of higher assessed risks of material misstatement of the group financial statements, or significant risks identified in accordance with AU-C section 315, on which a component auditor is determining the further audit procedures to be performed, the group auditor should evaluate the appropriateness of the design and performance of those further audit procedures. (Ref: par. 0)
45. When component auditors perform further audit procedures on the consolidation process, including on sub-consolidations, the group auditor should determine the nature and extent of direction and supervision of component auditors and the review of their work. (Ref: par.

²³ See, for example, FASB *Accounting Standards Codification* (ASC) 810, *Consolidation*.

0)

46. The group auditor should determine whether the financial information identified in the component auditor's communication (see paragraph 0a) is the financial information that is incorporated in the group financial statements.

Evaluating the Component Auditor's Communications and the Adequacy of The Work

47. The group auditor should request the component auditor to communicate matters relevant to the group auditor's conclusion with regard to the group audit. Such communication should include the following: (Ref: par. 0)
- a. Identification of the financial information on which the component auditor has been requested to perform audit procedures
 - b. Whether the component auditor has performed the work requested by the group auditor
 - c. Whether the component auditor has complied with the relevant ethical requirements, including those related to independence, that apply to the group audit engagement
 - d. Information about instances of noncompliance with laws or regulations
 - e. Corrected and uncorrected misstatements of the component financial information identified by the component auditor and that are above the threshold communicated by the group auditor in accordance with paragraph 0 (Ref: par. 0)
 - f. Indicators of possible management bias
 - g. Description of any deficiencies in the system of internal control identified in connection with the audit procedures performed
 - h. Fraud or suspected fraud involving component management, employees at entities or business units who have significant roles in the group's system of internal control at the component, or others at entities or business units where the fraud resulted in a material misstatement of the component financial information
 - i. Other significant matters that the component auditor communicated or expects to communicate to component management or those charged with governance of the component
 - j. Any other matters that may be relevant to the group audit, or that the component auditor determines are appropriate to draw to the attention of the group auditor, including exceptions noted in written representations that the component auditor requested from component management

ethical requirements that are relevant to the group audit engagement, including those related to independence

Competence and Capabilities of Referred-to Auditors

52. When making reference to the audit of a referred-to auditor, the group engagement partner should take responsibility for determining that referred-to auditors have the appropriate competence and capabilities. (Ref: par. 0–0)
53. The group auditor should obtain sufficient appropriate audit evidence relating to the work to be performed at the component without making reference to the audit of a referred-to auditor in the auditor’s report on the group financial statements if (Ref: par. 0–0)
 - a. the referred-to auditor does not comply with the relevant ethical requirements, including those related to independence, that apply to the group audit engagement, or
 - b. the group engagement partner has serious concerns about the matters in paragraphs 00.

Consolidation Process Considerations for Referred-to Auditors

54. When making reference to the audit of a referred-to auditor, the group auditor should obtain an understanding of whether the group auditor will be able to obtain information affecting the consolidation process from group management or a referred-to auditor.

Determining Whether to Make Reference to the Audit of a Referred-to Auditor (Ref: par. 0–0)

55. Having obtained an understanding of the referred-to auditor in paragraphs 0–0, the group engagement partner should determine whether to make reference to the audit of a referred-to auditor in the auditor’s report on the group financial statements.
56. Reference to the audit of a referred-to auditor in the auditor’s report on the group financial statements should not be made unless
 - a. the group engagement partner has determined that the referred-to auditor has performed an audit of the financial statements of the component in accordance with the relevant requirements of GAAS or the standards promulgated by the PCAOB (Ref: par. 0), and
 - b. the referred-to auditor has issued an auditor’s report that is not restricted as to use.
57. If the component’s financial statements are prepared using a different financial reporting framework from that used for the group financial statements, reference to the audit of a referred-to auditor in the auditor’s report on the group financial statements should not be made unless both of the following occur:

does not state that the audit of the component's financial statements was performed in accordance with GAAS or the standards promulgated by the PCAOB, and

- ii. the group engagement partner has determined that the referred-to auditor performed additional audit procedures in order to meet the relevant requirements of GAAS

- (1) the set of auditing standards used by the referred-to auditor and

- (2) that additional audit procedures were performed by the referred-to auditor to meet the relevant requirements of GAAS.

- 60. If the group engagement partner determines to name a referred-to auditor in the auditor's report on the group financial statements

- a. the referred-to auditor's express permission should be obtained, and

- b. the referred-to auditor's report should be presented together with that of the auditor's report on the group financial statements.

- 61. If the opinion of a referred-to auditor is modified or that audit report includes an emphasis-of-matter paragraph, an other-matter paragraph, or a Going Concern section, the group auditor should determine the effect that this may have on the auditor's report on the group financial statements. When deemed appropriate, the group auditor should modify the opinion on the group financial statements or include an emphasis-of-matter paragraph, an other-matter paragraph, or a Going Concern section in the auditor's report on the group financial statements. (Ref. par. 0)

Communications With the Referred-to Auditor (Ref: par. 0—**Error! Reference source not found.**)

- 62. The group auditor should communicate the following to a referred-to auditor on a timely basis:

- a. In accordance with paragraph 0, the ethical requirements that are relevant to the group audit engagement, including those related to independence

- b. Related party relationships or transactions identified by group management, and any other related parties of which the group auditor is aware, that are relevant to the work of the referred-to auditor (Ref: par. A184)

- c. Identified significant risks of the group financial statements, whether due to fraud or error, that are relevant to the work of the referred-to auditor

- d. A request that the referred-to auditor communicate the following on a timely basis:

- i. Confirmation that the referred-to auditor will cooperate with the group auditor

- ii. Related party relationships not previously identified by group management or the group auditor
 - iii. If the group engagement partner decides to name a referred-to auditor in the auditor's report on the group financial statements, the referred-to auditor's express permission for the group engagement partner to name the referred-to auditor in the auditor's report on the group financial statements in accordance with paragraph 0a.
- 63.** The group auditor should request a referred-to auditor to communicate matters relevant to the group auditor's conclusion with regard to the group audit. Such communication should include the following:
- a. Whether the referred-to auditor has complied with ethical requirements that are relevant to the group audit engagement, including independence
 - b. Identification of the financial information of the component on which the referred-to auditor is reporting
 - c. The referred-to auditor's report

Evaluating a Referred-to Auditor's Communication

- 64.** The group auditor should evaluate a referred-to auditor's communication (see paragraph 0d and 0). The group auditor should discuss significant findings and issues arising from that evaluation with the referred-to auditor, component management, or group management, as appropriate.
- 65.** The group auditor should determine whether the financial information identified in the referred-to auditor's communication (see paragraph 0b) is the financial information that is incorporated in the group financial statements.

Subsequent Events

- 66.** In applying AU-C section 560, *Subsequent Events and Subsequently Discovered Facts*,²⁴ the group auditor should take responsibility for performing procedures, including, as appropriate, requesting component auditors or referred-to auditors to perform procedures designed to identify events that may require adjustment of, or disclosure in, the group financial statements. (Ref: par. 0–0)

Considerations When Component Auditors Are Involved

- 67.** The group auditor should request the component auditors to notify the group auditor if they become aware of subsequent events that may require adjustment of, or disclosure in, the

²⁴ Paragraphs .09–.10 of AU-C section 560, *Subsequent Events and Subsequently Discovered Facts*.

group financial statements. (Ref: par. 0)

Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained

68. In applying AU-C section 330,²⁵ the group auditor should evaluate whether sufficient appropriate audit evidence has been obtained from the audit procedures performed (including from the work performed by component auditors, or through making reference to the audit of a referred-to auditor in the auditor's report on the group financial statements) on which to base the group audit opinion. (Ref: par. 0–0)
69. The group engagement partner should evaluate the effect on the group audit opinion of any uncorrected misstatements (whether identified by the group auditor or communicated by component auditors) and any instances when there has been an inability to obtain sufficient appropriate audit evidence. (Ref: par. 0)

Auditor's Report

Considerations When Component Auditors Are Involved (Ref: par. 0–0)

70. When component auditors are involved in the group audit, no reference should be made to the component auditor in the auditor's report on the group financial statements.

Communication With Group Management and Those Charged With Governance of the Group

Communication With Group Management

71. The group auditor should communicate with group management an overview of the planned scope and timing of the audit, including an overview of the work to be performed at components of the group. (Ref: par. 0)
72. If fraud has been identified by the group auditor or brought to its attention by a component auditor (see paragraph 0*h*) or referred-to auditor, or information indicates that a fraud may exist, the group auditor should communicate this on a timely basis to the appropriate level of group management to inform those with primary responsibility for the prevention and detection of fraud of matters relevant to their responsibilities. (Ref: par. 0)
73. When a component auditor or a referred-to auditor has been engaged to express an audit opinion on the financial statements of an entity or business unit that forms part of the group, the group auditor should request group management to inform management of the entity or business unit of any matter of which the group auditor becomes aware that may be significant to the financial statements of the entity or business unit, but of which management of the entity or business unit may be unaware. If group management refuses to communicate the matter to management of the entity or business unit, the group auditor

²⁵ Paragraph .28 of AU-C section 330.

should discuss the matter with those charged with governance of the group. If the matter remains unresolved, the group auditor, subject to legal and professional confidentiality considerations, should consider whether to advise the component auditor or referred-to auditor not to issue the auditor's report on the financial statements of the entity or business unit until the matter is resolved and whether to withdraw from the engagement. (Ref: par. 0–0)

Communication With Those Charged With Governance of the Group

74. The group auditor should communicate the following matters with those charged with governance of the group, in addition to those required by AU-C section 260, *The Auditor's Communication With Those Charged With Governance* and other AU-C sections: (Ref: par. 0)
- a. An overview of the work to be performed at the components of the group, including the basis for the decision to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements, and the nature of the group auditor's planned involvement in the work to be performed by component auditors (Ref: par. 0)
 - b. Instances when the group auditor's review of the work of a component auditor gave rise to a concern about the quality of that component auditor's work and how the group auditor addressed the concern
 - c. Any limitations on the scope of the group audit, for example, significant matters related to restrictions on access to people or information
 - d. Fraud or suspected fraud involving group management, component management, employees at entities or business units who have significant roles in the group's system of internal control, or others at entities or business units in which a material misstatement of the group financial statements has or may have resulted from fraud

Communication of Identified Deficiencies in Internal Control

75. In applying AU-C section 265, *Communicating Internal Control Related Matters Identified in an Audit*, the group auditor should determine whether any identified deficiencies in the group's system of internal control are required to be communicated to those charged with governance of the group or group management. In making this determination, the group auditor should consider deficiencies in internal control that have been identified by component auditors and communicated to the group auditor in accordance with paragraph 0g. (Ref: par. 0)

Documentation

76. In accordance with AU-C section 230,²⁶ the audit documentation for a group audit

²⁶ Paragraph .08 of AU-C section 230.

engagement needs to be sufficient to enable an experienced auditor, having no previous connection with the audit, to understand the nature, timing, and extent of audit procedures performed, the evidence obtained, and the conclusions reached with respect to significant matters arising during the group audit. In applying AU-C section 230,²⁷ the group auditor should include in the audit documentation the following: (Ref: par. 0–0, 0–0)

- a.* Significant matters related to restrictions on access to people or information within the group that were considered before deciding to accept or continue the engagement, or that arose subsequent to acceptance or continuance, and how such matters were addressed
- b.* The basis for the group auditor’s determination of components for purposes of planning and performing the group audit (Ref: par. 0)
- c.* The basis for the determination of component performance materiality and the threshold for communicating misstatements in the component financial information to the group auditor
- d.* The basis for the group auditor’s determination that component auditors have the appropriate competence and capabilities, including sufficient time, to perform the assigned audit procedures at the components (Ref: par. 0)
- e.* Key elements of the understanding of the group’s system of internal control in accordance with paragraph 0*c*
- f.* The nature, timing, and extent of the group auditor’s direction and supervision of component auditors and the review of their work, including, as applicable, the group auditor’s review of additional component auditor audit documentation in accordance with paragraph 0 (Ref: par. 0–0)
- g.* Matters related to communications with component auditors, including
 - i.* matters, if any, related to fraud, related parties, or going concern communicated in accordance with paragraph 0 and
 - ii.* matters relevant to the group auditor’s conclusion with regard to the group audit, in accordance with paragraph 0, including how the group auditor has addressed significant matters discussed with component auditors, component management, or group management.
- h.* Those components for which reference to the audit of referred-to auditors is made in the auditor’s report on the group financial statements, including the following for such components:
 - i.* The financial statements of the component and the auditor’s report of the referred-to auditor thereon

²⁷ Paragraphs .01–.03, .09–.12, .A8–.A9, and the exhibit in AU-C section 230.

- ii. When the referred-to auditor's report on the component's financial statements does not state that the audit of the component's financial statements was performed in accordance with GAAS or the standards promulgated by the PCAOB, the basis for the group engagement partner's determination that the audit performed by the referred-to auditor met the relevant requirements of GAAS
 - iii. The basis for the group auditor's determination that referred-to auditors have the appropriate competence and capabilities
 - iv. Matters related to communications with referred-to auditors communicated in accordance with paragraphs 0d and 0, including how the group auditor has addressed significant matters discussed with referred-to auditors, component management, or group management
- i. The group auditor's evaluation of, and response to, findings or conclusions of the component auditors or referred-to auditors about matters that could have a material effect on the group financial statements

* * *

Application and Other Explanatory Material

Scope of This Proposed SAS (Ref: par. 0–0)

- A1.** This proposed SAS also addresses the special considerations for the group engagement partner or group auditor, as applicable, in applying the requirements and guidance in the proposed QM SAS, including for the direction and supervision of component auditors and the review of their work.
- A2.** Proposed SQMS No. 1, *A Firm's System of Quality Management*, addresses the engagements for which an engagement quality review is required to be performed. Proposed SQMS No. 2, *Engagement Quality Reviews*, addresses the appointment and eligibility of the engagement quality reviewer and the engagement quality reviewer's responsibilities relating to performing and documenting an engagement quality review, including for a group audit.
- A3.** An entity or business unit of a group may also prepare its own group financial statements that incorporate the financial information of those entities or business units it encompasses (that is, a sub-group). This proposed SAS applies to an audit of the group financial statements of such sub-groups performed for legal, regulatory, or other reasons. When the group auditor is engaged to express opinions on both the group financial statements and the separate financial statements of the components presented in the group financial statements (for example, when auditing a governmental entity), the auditor is responsible for reporting on each audit engagement in accordance with AU-C sections.
- A4.** A single legal entity may be organized with more than one business unit, for example, a

company with operations in multiple locations, such as a bank with multiple branches. When those business units have characteristics such as separate locations, separate management, or separate information systems (including a separate general ledger) and the financial information is aggregated in preparing the single legal entity's financial statements, such financial statements meet the definition of *group financial statements* because they include the financial information of more than one entity or business unit through a consolidation process.

- A5.** In some cases, a single legal entity may configure its information system to capture financial information for more than one product or service line for legal or regulatory reporting or other management purposes. In these circumstances, the entity's financial statements are not group financial statements because there is no aggregation of the financial information of more than one entity or business unit through a consolidation process. Further, capturing separate information (for example, in a subledger) for legal or regulatory reporting or other management purposes does not create separate entities or business units (for example, divisions) for purposes of this proposed SAS.

Groups and Components (Ref: par. 0–0)

- A6.** The group's information system, including its financial reporting process, may or may not be aligned with the group's organizational structure. For example, a group may be organized according to its legal structure, but its information system may be organized by function, process, product, or service (or by groups of products or services), or geographic locations for management or reporting purposes.
- A7.** Based on the understanding of the group's organizational structure and information system, the group auditor may determine that the financial information of certain entities or business units may be considered together for purposes of planning and performing audit procedures. For example, a group may have three legal entities with similar business characteristics, operating in the same geographical location, under the same management, and using a common system of internal control, including the information system. In these circumstances, the group auditor may decide to treat these three legal entities as one component.
- A8.** A group may also centralize activities or processes that are applicable to more than one entity or business unit within the group, for example, through the use of a shared service center. When such centralized activities are relevant to the group's financial reporting process, the group auditor may determine that the shared service center is a component.
- A9.** Another consideration that may be relevant to the group auditor's determination of components is how management has determined operating segments in accordance with the disclosure requirements of the applicable financial reporting framework.²⁸

Involvement of Component Auditors (Ref: par. 0–0)

²⁸ See, for example, FASB ASC 280, *Segment Reporting*.

- A10.** Component auditors may perform an audit of the financial statements of a component, whether for legal, regulatory, or other reasons, particularly when a component is a legal entity. When a component auditor is also performing or has completed an audit of the component financial statements, the group auditor may be able to use audit work performed on the component financial statements, provided the group auditor is satisfied that such work is appropriate for purposes of the group audit. In addition, component auditors may adapt the work performed on the audit of the component financial statements to also meet the needs of the group auditor. In any event, the requirements of this proposed SAS apply, including those relating to the direction and supervision of component auditors and the review of their work.
- A11.** In accordance with the proposed QM SAS,²⁹ the engagement partner is required to determine that the approach to direction, supervision, and review is responsive to the nature and circumstances of the audit engagement. Paragraph 0 provides examples of different ways in which the group engagement partner may take responsibility for directing and supervising component auditors and reviewing their work and may be helpful in circumstances when the group auditor plans to use the audit work from an audit of component financial statements that has already been completed.
- A12.** As explained in AU-C section 200,³⁰ detection risk relates to the nature, timing, and extent of the auditor's procedures that are determined by the auditor to reduce audit risk to an acceptably low level. Detection risk is a function not only of the effectiveness of an audit procedure but also the application of that procedure by the auditor. Therefore, detection risk is influenced by matters such as adequate planning, the assignment of appropriate resources to the engagement, the maintenance of professional skepticism, and the supervision and review of the audit work performed.
- A13.** Detection risk is a broader concept than aggregation risk as described in paragraphs 0 and 0. In a group audit, there may be a higher probability that the aggregate of uncorrected and undetected misstatements may exceed materiality for the group financial statements as a whole because audit procedures may be performed separately on the financial information of components across the group. Accordingly, component performance materiality is set by the group auditor to reduce aggregation risk to an appropriately low level.

Professional Skepticism (Ref: par. 0)

- A14.** The proposed QM SAS³¹ provides examples of the impediments to the maintenance of professional skepticism at the engagement level, including unconscious auditor biases that may impede the maintenance of professional skepticism when designing and performing audit procedures and evaluating audit evidence. The proposed QM SAS also provides possible actions that the engagement team may take to mitigate impediments to the maintenance of professional skepticism at the engagement level.

²⁹ Paragraph 30b of the proposed QM SAS.

³⁰ Paragraph .A47 of AU-C section 200.

³¹ Paragraphs A34–A36 of the proposed QM SAS.

- A15.** Requirements and relevant application material in AU-C section 315,³² AU-C section 540, *Auditing Accounting Estimates and Related Disclosures*,³³ and other AU-C sections address the maintenance of professional skepticism and include examples of how documentation may help provide evidence of the auditor’s maintenance of professional skepticism.
- A16.** All members of the engagement team are required to maintain professional skepticism throughout the group audit. The group auditor’s direction and supervision of engagement team members, including component auditors, and the review of their work, may inform the group auditor about whether the engagement team has appropriately maintained professional skepticism.
- A17.** The maintenance of professional skepticism in a group audit may be affected by matters such as the following:
- Component auditors in different locations may be subject to varying cultural influences, which may affect the nature of the biases to which they are subject.
 - The complex structure of some groups may introduce factors that give rise to increased susceptibility to risks of material misstatement. In addition, an overly complex organizational structure may be a fraud risk factor in accordance with AU-C section 240, *Consideration of Fraud in a Financial Statement Audit*,³⁴ and therefore may require additional time or expertise to understand the business purpose and activities of certain entities or business units.
 - The nature and extent of intragroup transactions (for example, transactions that involve multiple entities and business units within the group or multiple related parties), cash flows, or transfer pricing agreements may give rise to additional complexities. In some cases, such matters may also give rise to fraud risk factors.
 - When the group audit is subject to tight reporting deadlines, this may put pressure on engagement team members when completing the work assigned. In these circumstances, the engagement team may need to take additional time to appropriately question management’s assertions, make appropriate judgments, or appropriately review the audit work performed.
- A18.** The maintenance of professional skepticism by the group auditor includes remaining alert for inconsistent information from component auditors, component management, and group management about matters that may be significant to the group financial statements.

Responsibilities of the Group Engagement Partner and Group Auditor (Ref: par. 0)

³² Paragraph .A268 of AU-C section 315.

³³ Paragraph .A11 of AU-C section 540, *Auditing Accounting Estimates and Related Disclosures*.

³⁴ Appendix A of AU-C section 240, *Consideration of Fraud in a Financial Statement Audit*.

A19. Component auditors may perform work on the financial information of the components for the group audit, or reference may be made to the audit of a referred-to auditor in the auditor's report on the group financial statements and, as such, component auditors and referred-to auditors are responsible for their overall findings or conclusions. However, regardless of whether reference is made in the auditor's report on the group financial statements to the report of a referred-to auditor, the group engagement partner or the group engagement partner's firm is responsible for the group audit opinion.

Definitions

Aggregation Risk (Ref: par. 0)

A20. Aggregation risk exists in all audits of financial statements but is particularly important to understand and address in a group audit because there is a greater likelihood that audit procedures will be performed on classes of transactions, account balances, or disclosures that are disaggregated across components. Generally, aggregation risk increases as the number of components at which audit procedures are performed separately increases, whether by component auditors or other members of the engagement team.

Component (Ref: par. 0)

A21. The group auditor uses professional judgment in determining components at which audit work will be performed. Paragraph 0 explains that the financial information of certain entities or business units may be considered together for purposes of planning and performing audit procedures. However, the group auditor's responsibility for the identification and assessment of the risks of material misstatement of the group financial statements encompasses all the entities and business units whose financial information is included in the group financial statements.

Considerations Specific to Governmental Entities (Ref: par. 0)

A22. In audits of state and local governments, a component may be a separate legal entity reported as a component unit or part of the governmental entity, such as a business activity, department, or program.

Component Auditor (Ref: par. 0)

A23. References in this proposed SAS to the engagement team include the group auditor and component auditors. Component auditors may be from a network firm, a firm that is not a network firm, or the group auditor's firm (for example, another office within the group auditor's firm).

A24. An auditor who performs work on a component when the group auditor will not use that work to provide audit evidence for the group audit is not considered a component auditor.

A25. In some circumstances, the group auditor may perform centralized testing on classes of

transactions, account balances, or disclosures, or may perform audit procedures related to a component. In these circumstances, the group auditor is not considered a component auditor.

- A26.** Paragraph 0 requires the group auditor to request the component auditor to confirm that the component auditor will cooperate with the group auditor and perform the work requested by the group auditor. Paragraph 0 provides guidance for circumstances in which the component auditor is unable to provide such a confirmation.

Component Management (Ref: par. 0)

- A27.** *Component management* refers to management responsible for the financial information or other activity (for example, processing of transactions at a shared service center) at an entity or business unit that is part of the group. When the group auditor considers the financial information of certain entities or business units together as a component or determines that a shared service center is a component (see paragraphs 0–0), component management refers to the management that is responsible for the financial information or transaction processing that is subject to the audit procedures being performed in relation to that component. In some circumstances, there may not be separate component management, and group management may be directly responsible for the financial information or other activities of the component.

Group Engagement Partner (Ref: par. 16)

- A28.** When joint auditors conduct a group audit, the joint engagement partners and their engagement teams collectively constitute the “group engagement partner” and “engagement team” for the purposes of GAAS. This proposed SAS does not, however, deal with the relationship between joint auditors or the work that one joint auditor performs in relation to the work of the other joint auditor for purposes of the group audit.

Group Financial Statements (Ref: par. 0, 16)

- A29.** The requirements for the preparation and fair presentation of the group financial statements may be specified in the applicable financial reporting framework, which may, therefore, affect the determination of the financial information of entities or business units to be included in the group financial statements. For example, some frameworks require the preparation of consolidated financial statements when an entity (a parent entity) controls one or more other entities (for example, subsidiaries) through majority ownership interest or other means. In some cases, the applicable financial reporting framework includes separate requirements for, or may otherwise permit, the presentation of combined financial statements. Examples of circumstances in which the presentation of combined financial statements may be permitted include entities that are under common control or entities under common management.
- A30.** The term *consolidation process* as used in this proposed SAS is not intended to have the same meaning as *consolidation* or *consolidated financial statements* as defined or

described in financial reporting frameworks. Rather, consolidation process refers more broadly to the process used to prepare group financial statements.

- A31.** The detailed aspects of the consolidation process vary from one group to another, depending on the group's structure and information system, including the financial reporting process. However, a consolidation process involves considerations such as the elimination of intra-group transactions and balances and, when applicable, implications of different reporting periods for entities or business units included in the group financial statements.

Considerations Specific to Governmental Entities (Ref: par. 0, 0)

- A32.** In audits of state and local governments, the applicable financial reporting framework may be based on multiple reporting units. Therefore, the consolidation process may involve the inclusion, but separate presentation, of the financial statements of each reporting unit in the governmental entity.

Leadership Responsibilities for Managing and Achieving Quality on a Group Audit (Ref: par. 0, 0)

- A33.** It may not be possible or practical for the group engagement partner to solely deal with all requirements in the proposed QM SAS, particularly when the engagement team includes a large number of component auditors located in multiple locations. In managing quality at the engagement level, the proposed QM SAS³⁵ permits the engagement partner to assign the design or performance of procedures, tasks, or actions to other members of the engagement team to assist the engagement partner. Accordingly, the group engagement partner may assign procedures, tasks, or actions to other members of the engagement team, and these members may assign procedures, tasks, or actions further. In such circumstances, the proposed QM SAS requires that the engagement partner should continue to take overall responsibility for managing and achieving quality on the audit engagement.
- A34.** Policies or procedures established by the firm, or that are common network requirements or network services,³⁶ may support the group engagement partner by facilitating communication between the group auditor and component auditors and supporting the group auditor's direction and supervision of those component auditors and the review of their work.
- A35.** The proposed QM SAS³⁷ explains that a culture that demonstrates a commitment to quality is shaped and reinforced by the engagement team members as they demonstrate expected behaviors when performing the engagement. In addressing the requirement in paragraph 0a, the group engagement partner may communicate directly to other members of the engagement team (including component auditors) and reinforce this communication through personal conduct and actions (for example, leading by example).

³⁵ Paragraph 15 of the proposed QM SAS.

³⁶ Paragraphs 49–53 of proposed SQMS No. 1, *Engagement Quality Reviews*.

³⁷ Paragraph A28 of the proposed QM SAS.

Acceptance and Continuance

Determining Whether Sufficient and Appropriate Audit Evidence Can Reasonably Be Expected to Be Obtained (Ref: par. 0–0)

A36. In determining whether sufficient appropriate audit evidence can reasonably be expected to be obtained, the group engagement partner may obtain an understanding of matters such as the following:

- The group structure, including both the legal and organizational structure
- Activities that are significant to the group, including the industry and regulatory, economic, and political environments in which those activities take place
- The use of service organizations
- The use of shared service centers
- The consolidation process
- Whether the group auditor
 - will have unrestricted access to those charged with governance of the group, group management, those charged with governance of the component, component management and component information, including of those components that are accounted for by the equity method, and
 - will be able to perform necessary work on the financial information of the components when applicable
- Whether sufficient and appropriate resources are assigned or will be made available

A37. In the case of an initial group audit engagement, the group auditor's understanding of the matters in paragraph 0 may be obtained from

- information provided by group management,
- communication with group management,
- communication with those charged with governance of the group, and
- when applicable, communication with component management or the predecessor auditor.

A38. For a recurring engagement, the ability to obtain sufficient appropriate audit evidence may

be affected by significant changes, for example, changes in the following:

- The group structure (for example, acquisitions, disposals, joint ventures, reorganizations, or changes in how the group financial reporting system is organized)
- Components' activities that are significant to the group
- The composition of those charged with governance of the group, group management, or key management of components for which audit procedures are expected to be performed
- The group auditor's understanding of the integrity and competence of group or component management
- Changes in the applicable financial reporting framework

A39. There may be additional complexities with obtaining sufficient appropriate audit evidence in a group audit when components are located in jurisdictions other than the group auditor's jurisdiction because of cultural and language differences, and different laws or regulations. For example, law or regulation may restrict the component auditor from providing documentation outside of its jurisdiction, or war, civil unrest, or outbreaks of disease may restrict the group auditor's access to relevant component auditor audit documentation. Paragraph 0 includes possible ways to address these situations.

A40. In addition to the work performed by the group auditor, the group engagement partner may obtain sufficient appropriate audit evidence regarding the financial information of one or more components through using the work of a component auditor or through making reference to the audit of a referred-to auditor in the auditor's report on the group financial statements.

A41. There may be more complexities in determining whether sufficient appropriate audit evidence can reasonably be expected to be obtained in a group audit where reference is made to the audit of referred-to auditors in the auditor's report on the group financial statements, including in group audits where no component auditors are also involved. The group engagement partner may consider the nature and extent of work performed by referred-to auditors, including matters such as the following:

- The financial significance of the components that are audited by referred-to auditors
- The risks of material misstatement to the group financial statements associated with the portion of the company's financial statements for which the group auditor or component auditor performs audit procedures compared to the portion audited by referred-to auditors

As the magnitude of the portion of the financial statements that is audited by referred-to

auditors increases, it is less likely that the group engagement partner can conclude that sufficient appropriate audit evidence can be obtained.

A42. Restrictions may be imposed after the group engagement partner's acceptance of the group audit engagement that may affect the engagement team's ability to obtain sufficient appropriate audit evidence. Such restrictions may include those affecting

- the group auditor's access to component information, management or those charged with governance of components, or the component auditors (including relevant audit documentation sought by the group auditor) (see paragraphs 0 and 0), or
- the work to be performed on the financial information of components.

Paragraphs 0–0 explain the possible effect of such restrictions on the auditor's report on the group financial statements.

Considerations Specific to Governmental Entities (Ref: par. 0)

A43. In audits of state and local governments, when reference is made to the audit of referred-to auditors in the auditor's report on the group financial statements, the following are additional factors to consider in determining whether sufficient appropriate audit evidence can reasonably be expected to be obtained:

- Engagement by the primary government as the auditor of the financial reporting entity
- Responsibility for auditing the primary government's general fund (or other primary operating fund)

Agreeing the Terms of Audit Engagements (Ref: par. 0)

A44. AU-C section 210³⁸ requires the auditor to agree upon the terms of the audit engagement with management or those charged with governance, as appropriate. The terms of engagement identify the applicable financial reporting framework. Additional matters that may be included in the terms of a group audit engagement include whether reference will be made to the audit of a referred-to auditor in the auditor's report on the group financial statements, when relevant, or arrangements to facilitate the following:

- Unrestricted communications between the group auditor and component auditors, to the extent permitted by laws or regulations
- Communications to the group auditor of important communications between
 - component auditors and those charged with governance of the component

³⁸ Paragraphs .09 and .10e of AU-C section 210.

or component management, including communications on significant deficiencies and material weaknesses in internal control and

— regulatory authorities and entities or business units related to financial reporting matters that may be relevant to the group audit

- Permission for the group auditor to perform work, or request a component auditor to perform work, at the component

Restrictions on Access to Information or People (Ref: par. 0–0)

A45. Restrictions on access to information or people do not eliminate the requirement for the group auditor to obtain sufficient appropriate audit evidence.

A46. Access to information or people can be restricted for many reasons, such as restrictions imposed by component management, laws or regulations, or other conditions, for example, war, civil unrest, or outbreaks of disease. Paragraph 0 describes how the group auditor may be able to overcome restrictions on access to component auditor audit documentation.

A47. In some circumstances, the group auditor may be able to overcome restrictions on access to information or people. Examples follow:

- If access to component management or those charged with governance of the component is restricted, the group auditor may request group management or those charged with governance of the group to assist with removing the restriction or otherwise request information directly from group management or those charged with governance of the group.
- If the group has a noncontrolling interest in an entity that is accounted for by the equity method, the group auditor may determine whether provisions exist (for example, in the terms of joint venture agreements or the terms of other investment agreements) regarding access by the group to the financial information of the entity and request group management to exercise such rights.
- If the group has a noncontrolling interest in an entity that is accounted for by the equity method and the group has representatives who are on the executive board or are members of those charged with governance of the noncontrolled entity, the group auditor may inquire whether they can provide financial and other information available to them in these roles.

A48. If the group has a noncontrolling interest in an entity that is accounted for by the equity method and the group auditor's access to information or people at the entity is restricted, the group auditor may be able to obtain information to be used as audit evidence regarding the entity's financial information, for example, from the following:

- Financial information that is available from group management because group

management also needs to obtain the noncontrolled entity's financial information in order to prepare the group financial statements

- Publicly available information, such as audited financial statements, public disclosure documents, or quoted prices of equity instruments in the noncontrolled entity
- Financial statements audited by a referred-to auditor when the group auditor makes reference to the audit of a referred-to auditor in the auditor's report on the group financial statements

It is a matter of professional judgment, particularly in view of the assessed risks of material misstatement of the group financial statements and considering other sources of information that may corroborate or otherwise contribute to audit evidence obtained, whether the auditor can obtain sufficient appropriate audit evidence.³⁹

A49. If the group has a noncontrolling interest in an entity that is accounted for by the equity method and access to information or people at the entity is restricted, the group auditor may consider whether such restrictions are inconsistent with group management's assertions regarding the appropriateness of the use of the equity method of accounting.

A50. When the group auditor is unable to obtain sufficient appropriate audit evidence due to restrictions on access to information or people, the group auditor may

- communicate the restrictions to the group auditor's firm to assist the group auditor in determining an appropriate course of action. For example, the group auditor's firm may communicate with group management about the restrictions and encourage group management to communicate with regulators. This may be useful when restrictions affect multiple audits in the jurisdiction or by the same firm, for example, because of war, civil unrest, or outbreaks of disease in a major economy.
- be required by law or regulation to communicate with regulators, listing authorities, or others about the restrictions.

A51. Restrictions on access may have other implications for the group audit. For example, if restrictions are imposed by group management, the group auditor may need to reconsider the reliability of group management's responses to the group auditor's inquiries and whether the restrictions call into question group management's integrity.

Effect of Restrictions on Access to Information or People on the Auditor's Report on Group Financial Statements

A52. AU-C section 705, *Modifications to the Opinion in the Independent Auditor's Report*, contains requirements and guidance about how to address situations when the group auditor

³⁹ Paragraph .07b of AU-C section 330.

is unable to obtain sufficient appropriate audit evidence. Illustration 1 in exhibit B, “Illustrative Auditor’s Reports on Group Financial Statements,” contains an example of an auditor’s report containing a qualified group audit opinion based on the group auditor’s inability to obtain sufficient appropriate audit evidence in relation to a component that is accounted for by the equity method.

Law or Regulation Prohibits the Group Engagement Partner From Declining or Withdrawing From an Engagement

A53. AU-C section 210 addresses circumstances when an entity is required by law or regulation to have an audit. In these circumstances, this proposed SAS still applies to the group audit, and the effect of the group auditor’s inability to obtain sufficient appropriate audit evidence is addressed in AU-C section 705.

Overall Group Audit Strategy and Group Audit Plan

The Continual and Iterative Nature of Planning and Performing a Group Audit (Ref: par. 0)

A54. As explained in AU-C section 300,⁴⁰ planning is not a discrete phase of an audit but, rather, a continual and iterative process that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement. For example, due to unexpected events, changes in conditions, or audit evidence obtained from risk assessment or further audit procedures, the group auditor may need to modify the overall group audit strategy and group audit plan, and the resulting planned nature, timing, and extent of further audit procedures, based on the revised consideration of assessed risks. The group auditor may also modify the determination of the components at which to perform audit work as well as the nature, timing, and extent of the component auditors’ involvement. AU-C section 300⁴¹ requires the auditor to update and change the overall audit strategy and audit plan as necessary during the course of the audit.

A55. The form of the group audit strategy and group audit plan may vary based on the nature and circumstances of each group audit engagement, including the extent to which engagement management is integrated into the audit tools used for the group audit. An electronic audit tool may be used to develop and update the group audit strategy and audit plan and facilitate the group engagement partner’s review of the group audit plan and group audit strategy.

Establishing the Overall Group Audit Strategy and Group Audit Plan (Ref: par. 0)

A56. In an initial group audit engagement, the group auditor may have a preliminary understanding of the group and its environment, the applicable financial reporting framework, and the entity’s system of internal control based on information obtained from group management, those charged with governance of the group and, when applicable,

⁴⁰ Paragraph .A2 of AU-C section 300.

⁴¹ Paragraph .10 of AU-C section 300.

communication with component management or the predecessor auditor. In a recurring group audit engagement, the group auditor's preliminary understanding may be obtained through prior period audits. This preliminary understanding may assist the group auditor in developing initial expectations about the classes of transactions, account balances, and disclosures that may be significant.

- A57.** The group auditor may also use information obtained during the engagement acceptance and continuance process in establishing the overall group audit strategy and group audit plan, for example, in relation to the resources needed to perform the group audit.
- A58.** The process of establishing the overall group audit strategy and group audit plan and initial expectations about the classes of transactions, account balances, and disclosures that may be significant at the group financial statement level may assist the group auditor in developing a preliminary determination of matters such as the following:
- Whether to perform audit work centrally, at components, or a combination thereof
 - The nature, timing, and extent of audit work to be performed with respect to the financial information of components (for example, design and perform risk assessment procedures, further audit procedures, or a combination thereof)
 - The components for which, if any, the auditor's report on the group financial statements will make reference to the audit of a referred-to auditor

Components at Which to Perform Audit Work (Ref: par. 0a)

- A59.** The determination of components at which to perform audit work is a matter of professional judgment. The following are examples of matters that may influence the group auditor's determination:
- The nature of events or conditions that may give rise to risks of material misstatement at the assertion level of the group financial statements that are associated with a component, for example
 - newly formed or acquired entities or business units,
 - entities or business units in which significant changes have taken place,
 - significant transactions with related parties,
 - significant unusual transactions, and
 - abnormal fluctuations identified by analytical procedures performed at the group level, in accordance with AU-C section 315.⁴²

⁴² Paragraph .14b of AU-C section 315.

- The disaggregation of significant classes of transactions, account balances, and disclosures in the group financial statements across components, considering the size and nature of assets, liabilities, and transactions at the location or business unit relative to the group financial statements
- Whether sufficient appropriate audit evidence is expected to be obtained for all significant classes of transactions, account balances, and disclosures in the group financial statements from audit work planned on the financial information of identified components
- The nature and extent of misstatements or control deficiencies identified at a component in prior period audits
- The nature and extent of the commonality of controls across the group and whether, and if so, how, the group centralizes activities relevant to financial reporting

Considerations Specific to Governmental Entities (Ref: par. 0a)

A60. In audits of governmental entities, the following are examples of matters that may influence the group auditor's determination of components at which to perform audit work:

- The disaggregation of significant classes of transactions, account balances, and disclosures (for example, net costs or total budget) in the group financial statements across components, considering the size and nature of assets, liabilities, and transactions, at the component unit, business activity, department, or program relative to the group financial statements
- The materiality of the component relative to its related opinion unit as set forth in the Audit and Accounting Guide *State and Local Governments*
- Matters of heightened public sensitivity, such as national security issues, donor-funded projects, or reporting of tax revenue

Resources (Ref: par. 0b)

A61. Matters that influence the group auditor's determination of the resources needed to perform the group audit and the nature, timing, and extent to which component auditors are to be involved are a matter of professional judgment. The following are examples of such matters:

- The understanding of the group, the components within the group at which audit work is to be performed, and whether to perform work centrally, at components, or a combination thereof.
- The knowledge and experience of the engagement team. For example, component auditors may have greater experience and a more in-depth knowledge than the group

auditor of the local industries in which components operate, local laws or regulations, business practices, language, and culture. In addition, the involvement of auditor's specialists may be needed on complex matters.

- The initial expectations about the potential risks of material misstatement.
- The amount or location of resources to allocate to specific audit areas. For example, the extent to which components are dispersed across multiple locations may affect the need to involve component auditors in specific locations.
- Access arrangements. For example, when the group auditor's access to a component in a particular jurisdiction is restricted, component auditors may need to be involved.
- The nature of the components' activities, including their complexity or specialization of operations.
- The group's system of internal control, including the information system in place and its degree of centralization. For example, the involvement of component auditors may be more likely when the system of internal control is decentralized.
- Previous experience with the component auditor.

A62. Component auditors may be involved in different phases of an audit. For example, component auditors may design or perform

- risk assessment procedures, and
- procedures to respond to the assessed risks of material misstatement.

A63. The nature, timing, and extent to which component auditors are to be involved depends on the facts and circumstances of the group audit engagement. Often component auditors will be involved in all phases of the audit, but the group auditor may decide to involve component auditors only in a certain phase. When the group auditor does not intend to involve component auditors in risk assessment procedures, the group auditor may still discuss with component auditors whether there are any significant changes in the business or the system of internal control of the component that could have an effect on the risks of material misstatement of the group financial statements.

A64. AU-C section 300⁴³ requires the engagement partner and other key members of the engagement team to be involved in planning the audit. When component auditors are involved, one or more individuals from a component auditor may be key members of the engagement team and therefore involved in planning the group audit. The involvement of

⁴³ Paragraph .05 of AU-C section 300.

component auditors in planning the audit draws on their experience and insight, thereby enhancing the effectiveness and efficiency of the planning process. The group engagement partner uses professional judgment in determining which component auditors to involve in planning the audit. This may be affected by the nature, timing, and extent to which the component auditors are expected to be involved in designing and performing risk assessment or further audit procedures.

- A65.** As described in proposed SQMS No. 1,⁴⁴ there may be circumstances when the fee quoted for an engagement is not sufficient given the nature and circumstances of the engagement, and it may diminish the firm's ability to perform the engagement in accordance with professional standards and applicable legal or regulatory requirements. The level of fees, including, when applicable, their allocation to component auditors, and the extent to which they relate to the resources required, may be a special consideration for group audit engagements. For example, in a group audit, the firm's financial and operational priorities may place constraints on the determination of the components at which audit work will be performed, as well as the resources needed, including the involvement of component auditors. In such circumstances, these constraints do not alleviate the group engagement partner's responsibility for achieving quality at the engagement level or the requirements for the group auditor to obtain sufficient appropriate audit evidence on which to base the group audit opinion.

Considerations When Component Auditors Are Involved

Sufficient and Appropriate Involvement in the Work of the Component Auditor (Ref: par. 0–0)

- A66.** In evaluating whether the group auditor will be able to be sufficiently and appropriately involved in the work of the component auditor, the group auditor may obtain an understanding of whether the component auditor is subject to any restrictions that limit communication with the group auditor, including with regard to sharing audit documentation with the group auditor. The group auditor may also obtain an understanding about whether audit evidence related to components located in a different jurisdiction may be in a different language and may need to be translated for use by the group auditor.
- A67.** If the component auditor is unable to cooperate with the group auditor, the group auditor may do the following:
- Request the component auditor to provide its rationale.
 - Be able to take appropriate action to address the matter, including adjusting the nature of the work requested to be performed. Alternatively, in accordance with paragraph 0, the group auditor may need to obtain sufficient appropriate audit evidence relating to the work to be performed at the component without involving the component auditor.

⁴⁴ Paragraph A78 of proposed SQMS No. 1.

Relevant Ethical Requirements, Including Those Related to Independence (Ref: par. 0)

- A68.** When performing work at a component for a group audit engagement, the component auditor is subject to ethical requirements, including those related to independence, that are relevant to the group audit engagement. Such requirements may be different from or in addition to those applying to the component auditor when performing an audit on the financial statements of an entity or business unit that is part of the group for legal, regulatory, or other reasons in the component auditor's jurisdiction. When the component auditor is not subject to the AICPA Code of Professional Conduct, compliance by the component auditor with the ethics and independence requirements set forth in the International Federation of Accountants Code of Ethics for Professional Accountants is sufficient to fulfill the component auditor's ethical responsibilities in the group audit.
- A69.** In making the component auditor aware of relevant ethical requirements, the group auditor may consider whether additional information or training for component auditors is necessary regarding the provisions of the ethical requirements that are relevant to the group audit engagement.

Engagement Resources (Ref: par. 0)

- A70.** The proposed QM SAS⁴⁵ requires the engagement partner to determine that sufficient and appropriate resources to perform the engagement are assigned or made available to the engagement team in a timely manner. When sufficient or appropriate resources are not made available in relation to work to be performed by a component auditor, the group engagement partner may discuss the matter with the component auditor, group management, or the group auditor's firm and may subsequently request the component auditor or the group auditor's firm to make sufficient and appropriate resources available.

Competence and Capabilities of the Component Auditor

- A71.** The proposed QM SAS⁴⁶ provides guidance regarding matters the engagement partner may take into consideration when determining the competence and capabilities of the engagement team. This determination is particularly important in a group audit when the engagement team includes component auditors. The proposed QM SAS⁴⁷ indicates that the firm's policies or procedures may require the firm or the engagement partner to take different actions from those applicable to personnel when obtaining an understanding of whether a component auditor from another firm has the appropriate competence and capabilities to perform the audit engagement.
- A72.** Determining whether component auditors have the appropriate competence and capabilities is a matter of professional judgment and is influenced by the nature and circumstances of the group audit engagement. This determination influences the nature, timing, and extent of the group engagement partner's direction and supervision of the

⁴⁵ Paragraph 25 of the proposed QM SAS.

⁴⁶ Paragraph A71 of the proposed QM SAS.

⁴⁷ Paragraph A24 of the proposed QM SAS.

component auditor and the review of their work.

A73. In determining whether component auditors have the appropriate competence and capabilities to perform the assigned audit procedures at the component, the group engagement partner may consider matters such as the following:

- Previous experience with or knowledge of the component auditor
- The component auditor's specialized skills (for example, industry-specific knowledge or knowledge of relevant financial reporting requirements for statements and schedules to be filed with regulatory agencies)
- The component auditor's understanding of the auditing and other standards applicable to the group audit, such as GAAS, that is sufficient to fulfill the component auditor's responsibilities
- The degree to which the group auditor and component auditor are subject to a common system of quality management, for example, whether the group auditor and a component auditor
 - use common resources to perform the work (for example, audit methodologies or IT applications),
 - share common policies or procedures affecting engagement performance (for example, direction, supervision, and review of work or consultation),
 - are subject to common monitoring activities, or
 - have other commonalities, including common leadership or a common cultural environment
- The consistency or similarity of
 - laws or regulations or legal system;
 - language and culture;
 - education and training;
 - professional oversight, discipline, and external quality assurance; or
 - professional organizations and standards
- Information obtained about the component auditor through interactions with component management, those charged with governance, and other key personnel, such as internal auditors

A74. The procedures to determine the component auditor’s competency and capability may include, for example, the following:

- An evaluation of the information communicated by the group auditor’s firm to the group auditor, including
 - the firm’s ongoing communication related to monitoring and remediation, in circumstances when the group auditor and component auditor are from the same firm⁴⁸
 - information from the network about the results of the monitoring activities undertaken by the network across the network firms⁴⁹
 - information obtained from professional bodies to which the component auditor belongs, the authorities by which the component auditor is licensed, or other third parties
- Discussing the assessed risks of material misstatement with the component auditor
- Requesting the component auditor to confirm its understanding of the matters referred to in paragraph 0 in writing
- Discussing the component auditor’s competence and capabilities with colleagues in the group engagement partner’s firm that have worked directly with the component auditor
- Obtaining published external inspection reports, peer review reports on the component auditor’s firm, and other relevant publicly available information relating to the professional reputation and standing of a component auditor

A75. The group engagement partner’s firm and the component auditor may be members of the same network and may be subject to common network requirements or use common network services.⁵⁰ When determining whether component auditors have the appropriate competence and capabilities to perform work in support of the group audit engagement, the group engagement partner may be able to depend on such network requirements, for example, those addressing professional training or recruitment or that require the use of audit methodologies and related implementation tools. In accordance with proposed SQMS No. 1,⁵¹ the firm is responsible for designing, implementing, and operating its system of quality management, and the firm may need to adapt or supplement network requirements or network services to be appropriate for use in its system of quality management.

⁴⁸ Paragraph 48 of proposed SQMS No. 1.

⁴⁹ Paragraph 52*b* of proposed SQMS No. 1.

⁵⁰ Paragraphs A20 and A188 of proposed SQMS No. 1.

⁵¹ Paragraphs 49–50 of proposed SQMS No. 1.

Using the Work of an Auditor's Specialist

A76. The proposed QM SAS⁵² requires the engagement partner to determine that members of the engagement team, and any auditor's external specialists who are not part of the engagement team, collectively have the appropriate competence and capabilities, including sufficient time, to perform the audit engagement. If an auditor's specialist is used by a component auditor, the group engagement partner may need to obtain information from the component auditor. For example, the group auditor may discuss with the component auditor, the component auditor's evaluation of the competence and capabilities of the auditor's specialist.

Automated Tools and Techniques

A77. When determining whether the engagement team has the appropriate competence and capabilities, the group engagement partner may take into consideration such matters as the expertise of the component auditor in the use of automated tools and techniques. For example, as described in the proposed QM SAS,⁵³ when the group auditor requires component auditors to use specific automated tools and techniques when performing audit procedures, the group auditor may communicate with component auditors that the use of such automated tools and techniques need to comply with the group auditor's instructions.

Application of the Group Auditor's Understanding of a Component Auditor (Ref: par. 0)

A78. The proposed QM SAS⁵⁴ requires the engagement partner to take responsibility for other members of the engagement team, having been made aware of relevant ethical requirements that are applicable given the nature and circumstances of the audit engagement, and the firm's related policies or procedures. This includes the firm's policies or procedures that address circumstances that may cause a breach of relevant ethical requirements, including those related to independence, and the responsibilities of members of the engagement team when they become aware of breaches. The firm's policies or procedures also may address breaches of independence requirements by component auditors and actions the group auditor may take in those circumstances in accordance with the relevant ethical requirements. In addition, relevant ethical requirements or law or regulation may also specify particular communications to those charged with governance in circumstances when breaches of independence requirements have been identified.⁵⁵

A79. If there has been a breach by a component auditor of the relevant ethical requirements that apply to the group audit engagement, including those related to independence, and the breach has not been satisfactorily addressed in accordance with provisions of the relevant ethical requirements, the group auditor cannot use the work of that component auditor.

A80. Serious concerns are those concerns that in the group auditor's professional judgment

⁵² Paragraph 26 of the proposed QM SAS.

⁵³ Paragraph A65 of the proposed QM SAS.

⁵⁴ Paragraph 17 of the proposed QM SAS.

⁵⁵ Paragraph .A17 of AU-C section 260, *The Auditor's Communication With Those Charged With Governance*.

cannot be overcome. The group engagement partner may be able to overcome less-than-serious concerns about the component auditor's professional competency (for example, lack of industry-specific knowledge), or the fact that the component auditor does not operate in an environment that actively oversees auditors, by the group auditor being more involved in the work of the component auditor or by directly performing further audit procedures on the financial information of the component.

Engagement Performance (Ref: par. 0)

- A81.** The proposed QM SAS⁵⁶ requires the engagement partner to determine that the nature, timing, and extent of direction, supervision, and review is planned and performed in accordance with the firm's policies or procedures, professional standards, and applicable legal and regulatory requirements and is responsive to the nature and circumstances of the audit engagement and the resources assigned or made available to the engagement team. For a group audit, the approach to direction, supervision, and review will generally include a combination of addressing the group auditor's firm policies or procedures and group audit engagement-specific responses.
- A82.** For a group audit, particularly when the engagement team includes a large number of component auditors that may be located in multiple locations, the group engagement partner may assign the design or performance of procedures, tasks, or actions to other members of the engagement team to assist the group engagement partner in fulfilling the responsibility for the nature, timing, and extent of the direction and supervision of component auditors and the review of their work (see also paragraph 0).
- A83.** If component auditors are from a firm other than the group auditor's firm, the firm's policies or procedures may be different, or different actions may need to be taken, respectively, in relation to the nature, timing, and extent of direction and supervision of those members of the engagement team, and the review of their work. In particular, firm policies or procedures may require the firm or the group engagement partner to take different actions from those applicable to members of the engagement team within the firm or the network (for example, in relation to the form, content, and timing of communications with component auditors, including the use of group auditor instructions to component auditors). The proposed QM SAS provides examples of actions that may need to be taken in such circumstances.⁵⁷
- A84.** The nature, timing, and extent of direction and supervision of component auditors and review of their work may be tailored based on the nature and circumstances of the engagement and, for example, the following factors:
- The assessed risks of material misstatement. For example, if the group auditor has identified a component that includes a significant risk, an increase in the extent of direction and supervision of the component auditor and a more detailed review of the component auditor's audit documentation may be appropriate.

⁵⁶ Paragraph 30 of the proposed QM SAS.

⁵⁷ Paragraphs A24–A25 of the proposed QM SAS.

- The competence and capabilities of the component auditors performing the audit work. For example, if the group auditor has no previous experience working with a component auditor, the group auditor may communicate more detailed instructions, increase the frequency of discussions or other interactions with the component auditor, or assign more experienced individuals to oversee the component auditor as the work is performed.
- The location of engagement team members, including the extent to which engagement team members are dispersed across multiple locations, including when service delivery centers are used.
- Access to component auditor audit documentation. For example, when law or regulation precludes component auditor audit documentation from being transferred out of the component auditor's jurisdiction, the group auditor may be able to review the audit documentation at the component auditor's location or remotely through the use of technology, when not prohibited by law or regulation (see also paragraphs 0–0).

A85. The following are examples of different ways in which the group engagement partner may take responsibility for directing and supervising component auditors and reviewing their work:

- Communications with component auditors throughout the course of the group audit, including communications required by this proposed SAS
- Meetings or calls with component auditors to discuss identified and assessed risks, findings or issues, and conclusions
- Reviews of the component auditor's audit documentation in person or remotely when permitted by law and regulation
- Participating in closing or other key meetings between the component auditors and component management

A86. In applying proposed QM SAS,⁵⁸ the group engagement partner is required to review audit documentation at appropriate points in time during the audit engagement, including audit documentation relevant to the group audit relating to

- significant matters;
- significant judgments, including those relating to difficult or contentious matters identified during the audit engagement, and the conclusions reached; and

⁵⁸ Paragraphs 31 and A92–A93 of the proposed QM SAS.

- other matters that, in the engagement partner’s professional judgment, are relevant to the engagement partner’s responsibilities.

The review of such audit documentation by the group engagement partner often takes place during the course of the group audit, including the review of relevant component auditor audit documentation (also see paragraph 0). The group engagement partner exercises professional judgment in determining the nature and extent of the review of component auditor audit documentation.⁵⁹ Such review may constitute reviewing component auditor communications.

Communications With Component Auditors (Ref: par. 0)

A87. Clear and timely communication between the group auditor and the component auditors about their respective responsibilities, along with clear direction to the component auditors about the nature, timing, and extent of the work to be performed and the matters expected to be communicated to the group auditor, helps establish the basis for effective two-way communication. Effective two-way communication between the group auditor and the component auditors also helps to set expectations for component auditors and facilitates the group auditor’s direction and supervision of them and the review of their work. Such communication also provides an opportunity for the group engagement partner to reinforce the need for component auditors to maintain professional skepticism in the work performed for purposes of the group audit.

A88. The following are examples of other factors that may also contribute to effective two-way communication:

- Clarity of the instructions to the component auditor, particularly when the component auditor is from another firm and may not be familiar with the policies or procedures of the group auditor’s firm.
- A mutual understanding that the component auditor may discuss the audit work requested to be performed, based on the component auditor’s knowledge and understanding of the component.
- A mutual understanding of relevant issues and the expected actions arising from the communication process.
- The form of communications. For example, matters that need timely attention may be more appropriately discussed in a meeting rather than by exchanging emails.
- A mutual understanding of the persons from the group auditor and component auditors who have responsibility for managing communications regarding particular matters.

⁵⁹ Paragraph A91 of the proposed QM SAS.

- The process for the component auditor to take action and report back on matters communicated by the group auditor.

A89. The communications between the group auditor and component auditors depend on the facts and circumstances of the group audit engagement, including the nature and extent of involvement of the component auditors and the degree to which the group auditor and component auditors are subject to common systems of quality management or common network requirements or network services.

Form of Communications

A90. The form of the communications between the group auditor and component auditors may vary based on factors such as the nature of the audit work the component auditors have been requested to perform and the extent to which communication capabilities are integrated into the audit tools used for the group audit.

A91. The form of communications also may be affected by such factors as the following:

- The significance, complexity, or urgency of the matter
- Whether the matter has been or is expected to be communicated to group management and those charged with governance of the group
- Whether the group auditor and component auditor are from the same firm or network firms

A92. Communication between the group auditor and the component auditor may not necessarily be in writing. However, the group auditor's verbal communications with the component auditors may be supplemented by written communication, such as a set of instructions regarding the work to be performed, when the group auditor wants to give particular attention to, or promote a mutual understanding about, certain matters. In addition, the group auditor may meet with the component auditor to discuss significant matters or to review relevant parts of the component auditor's audit documentation.

A93. Paragraph 0 requires the group auditor to request of the component auditor to communicate matters relevant to the group auditor's conclusion with regard to the group audit. As explained in paragraph 0, the form and content of the component auditor's deliverables are influenced by the nature and extent of the audit work the component auditor has been requested to perform.

A94. Regardless of the form of communications between the group auditor and component auditors, the documentation requirements of this proposed SAS and other AU-C sections apply.

Timing of Communications

A95. The appropriate timing of communications will vary with the circumstances of the engagement. Relevant circumstances may include the nature, timing, and extent of work to be performed by the component auditor and the action expected to be taken by the component auditor. For example, communications regarding planning matters may often be made early in the audit engagement and, for an initial group audit, may be made as part of agreeing the terms of the engagement.

Noncompliance With Laws or Regulations (Ref: par. 0, 0)

A96. In applying AU-C section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*, the group engagement partner may become aware of information about noncompliance or suspected noncompliance with laws or regulations. In such circumstances, the group engagement partner may have an obligation under relevant ethical requirements, laws, or regulations to communicate the matter to the component auditor.⁶⁰

Understanding the Group and Its Environment, the Applicable Financial Reporting Framework, and the Group’s System of Internal Control (Ref: par. 0)

A97. AU-C section 315⁶¹ contains requirements and guidance regarding the auditor’s responsibility to obtain an understanding of the entity and its environment, the applicable financial reporting framework, and the entity’s system of internal control. Appendix A, “Understanding the Group’s System of Internal Control,” of this proposed SAS provides examples of matters related to controls that may be helpful in obtaining an understanding of the system of internal control in the context of a group environment and expands on how AU-C section 315 is to be applied to an audit of group financial statements.

A98. The group auditor’s understanding of the group and its environment, the applicable financial reporting framework, and the group’s system of internal control with respect to the components for which a referred-to auditor performs an audit may vary as compared to the components for which a component auditor performs audit procedures.

A99. The understanding of the group and its environment, the applicable financial reporting framework, and the group’s system of internal control may be obtained through communications with

- group management, component management, or other appropriate individuals within the entity, including individuals within the internal audit function (if the function exists) and individuals who have knowledge of the group’s system of internal control, accounting policies and practices, and the consolidation process;
- component auditors or referred-to auditors; or
- auditors that perform an audit for legal, regulatory, or other reasons of the financial

⁶⁰ See, for example, paragraphs 22–23 of the proposed “Responding to Noncompliance With Laws and Regulations” interpretation of the AICPA Code of Professional Conduct.

⁶¹ Paragraphs .19–.31 and .A58–.A212 of AU-C section 315.

statements of an entity or business unit that is part of the group.

A100. Obtaining an understanding of the group, identifying risks of material misstatement, and assessing inherent risk and control risk may be performed in different ways depending on preferred audit techniques or methodologies and may be expressed in different ways. Accordingly, when component auditors are involved in the design and performance of risk assessment procedures, the group auditor may communicate its preferred approach with component auditors or provide instructions.

Engagement Team Discussion (Ref: par.0)

A101. In applying AU-C section 315,⁶² the group engagement partner and other key engagement team members are required to discuss the application of the applicable financial reporting framework and the susceptibility of the group's financial statements to material misstatement. The group engagement partner's determination of which members of the engagement team to include in the discussion and the topics to be discussed is affected by matters such as initial expectations about the risks of material misstatement and the preliminary expectation of whether to involve component auditors.

A102. The discussion provides an opportunity to do the following:

- Share knowledge of the components and their environments, including which components' activities are centralized.
- Exchange information about the business risks of the components or the group and how inherent risk factors may affect susceptibility to misstatement of classes of transactions, account balances, and disclosures.
- Exchange ideas about how and where the group financial statements may be susceptible to material misstatement due to fraud or error. AU-C section 240⁶³ requires the engagement team discussion to place particular emphasis on how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud may occur.
- Identify policies followed by group or component management that may be biased or designed to manage earnings that could lead to fraudulent financial reporting.
- Consider known external and internal factors affecting the group that may create an incentive or pressure for group management, component management, or others to commit fraud, provide the opportunity for fraud to be perpetrated, or indicate a culture or environment that enables group management, component management, or others to rationalize committing fraud.

⁶² Paragraph .17 of AU-C section 315.

⁶³ Paragraph .15 of AU-C section 240.

- Consider the risk that group or component management may override controls.
- Discuss fraud that has been identified or information that indicates existence of a fraud.
- Identify risks of material misstatement relevant to components in which there may be impediments to the maintenance of professional skepticism.
- Consider whether uniform accounting policies are used to prepare the financial information of the components for the group financial statements and, if not, how differences in accounting policies are identified and adjusted (when required by the applicable financial reporting framework).
- Share information about risks of material misstatement of the financial information of a component that may apply more broadly to some, or all, of the other components.
- Share information that may indicate noncompliance with national laws or regulations, for example, payments of bribes and improper transfer pricing practices.
- Discuss events or conditions identified by group management, component management, or the engagement team that may raise substantial doubt about the group's ability to continue as a going concern for a reasonable period of time.
- Discuss related party relationships or transactions identified by group management or component management and any other related parties of which the engagement team is aware.

The Group and Its Environment (Ref: par. 0a)

A103. An understanding of the group's organizational structure and its business model may enable the group auditor to understand such matters as the following:

- The complexity of the group's structure. A group may be more complex than a single entity because a group may have several subsidiaries, divisions, or other business units, including in multiple locations. Also, a group's legal structure may be different from the operating structure, for example, for tax purposes. Complex structures often introduce factors that may give rise to increased susceptibility to material misstatements, such as whether goodwill, joint ventures, or variable interest entities are accounted for appropriately and whether adequate disclosures have been made.
- The geographic locations of the group's operations. Having a group that is located in multiple geographical locations may give rise to increased susceptibility to material misstatements. For example, different geographical locations may involve

different languages, cultures, and business practices.

- The structure and complexity of the group's IT environment. A complex IT environment often introduces factors that may give rise to increased susceptibility to material misstatements. For example, a group may have a complex IT environment because of multiple IT systems that are not integrated due to recent acquisitions or mergers. Therefore, it may be particularly important to obtain an understanding of the complexity of the security over the IT environment, including vulnerability of the IT applications, databases, and other aspects of the IT environment. A group may also use one or more external service providers for aspects of its IT environment.
- Relevant regulatory factors, including the regulatory environment. Different laws or regulations may introduce factors that may give rise to increased susceptibility to material misstatements. A group may have operations that are subject to a high degree of complex laws or regulations in multiple jurisdictions, or entities or business units in the group that operate in multiple industries that are subject to different types of laws or regulations.
- The ownership, and relationships between owners and other people or entities, including related parties. Understanding the ownership and relationships can be more complex in a group that operates across multiple jurisdictions and when there are changes in ownership through formation, acquisition, disposal, or joint venture. These factors may give rise to increased susceptibility to material misstatements.

A104. Obtaining an understanding of the degree to which the group's operations or activities are similar may help to identify similar risks of material misstatement across components and design an appropriate response.

A105. The financial results of entities or business units are ordinarily measured and reviewed by group management. Inquiries of group management may reveal that group management relies on certain key indicators to evaluate the financial performance of the group's entities and business units and take action. The understanding of such performance measures may help to identify

- areas where there is increased susceptibility to material misstatements (for example, due to pressures on component management to meet certain performance measures).
- controls over the group's financial reporting process.

The Group's System of Internal Control

The Nature and Extent of Commonality of Controls (Ref: par. 0c(i))

A106. Group management may design controls that are intended to operate in a common manner

across multiple entities or business units (that is, common controls). For example, group management may design common controls for inventory management, which operate using the same IT system and are implemented across all entities or business units in the group. Common controls may exist in each component of the group's system of internal control, and they may be implemented at different levels within the group (for example, at the level of the consolidated group as a whole or for other levels of aggregation within the group). Common controls may be direct controls or indirect controls. *Direct controls* are controls that are precise enough to address risks of material misstatement at the assertion level. *Indirect controls* are controls that support direct controls.⁶⁴

A107. Understanding the components of the group's system of internal control includes understanding the commonality of tasks and actions, structures, processes, or controls within those components across the group. In understanding the commonality of a control across the group, considerations that may be relevant include whether

- the control is designed centrally and is required to be implemented as designed (that is, without modification) at some or all components;
- the control is implemented and, if applicable, monitored by individuals with similar responsibilities and capabilities at all the components where the control is implemented;
- if a control uses information from IT applications, the IT applications and other aspects of the IT environment that generate the information are the same across the components or locations; or
- if the control is automated, it is configured in the same way in each IT application across the components.

A108. Judgment may often be needed to determine whether a control is a common control. For example, group management may require that all entities and business units perform a monthly evaluation of the aging of customers' accounts that are generated from a specific IT application. When the aging reports are generated from different IT applications or the implementation of the IT application differs across entities or business units, there may be a need to consider whether the control can be determined to be common. This is because of differences in the design of the control that may exist due to the existence of different IT applications (for example, whether the IT application is configured in the same manner across components and whether there are effective general IT controls across different IT applications).

A109. Consideration of the level at which controls are performed within the group (for example, at the level of the consolidated group as a whole or for other levels of aggregation within the group) and the degree of centralization and commonality may be important to the understanding of how information is processed and controlled. In some circumstances,

⁶⁴ Paragraph .A5 of AU-C section 315.

controls may be performed centrally (for example, performed only at a single entity or business unit) but may have a pervasive effect on other entities or business units (for example, a shared service center that processes transactions on behalf of other entities or business units within the group). The processing of transactions and related controls at a shared service center may operate in the same way for those transactions being processed by the shared service center regardless of the entity or business unit (for example, the processes, risks of material misstatement, and controls may be the same regardless of the source of the transaction). In such cases, it may be appropriate to identify the controls and evaluate the design and determine the implementation of the controls, and, if applicable, test operating effectiveness, as a single population.

Centralized Activities (Ref: par. 0c(i)–(ii))

- A110.** Group management may centralize some of its activities. For example, financial reporting or accounting functions may be performed for a particular group of common transactions or other financial information in a consistent and centralized manner for multiple entities or business units (for example, when the initiation, authorization, recording, processing, or reporting of revenue transactions is performed at a shared service center).
- A111.** Obtaining an understanding of how centralized activities fit into the overall group structure, and the nature of the activities undertaken, may help to identify and assess risks of material misstatement and appropriately respond to such risks. For example, controls at a shared service center may operate independently from other controls, or they may be dependent upon controls at an entity or business unit from which financial information is derived (for example, sales transactions may be initiated and authorized at an entity or business unit, but the processing may occur at the shared service center).
- A112.** The group auditor may involve component auditors in testing the operating effectiveness of common controls or controls related to centralized activities. In such circumstances, effective collaboration between the group auditor and component auditors is important because the audit evidence obtained through testing the operating effectiveness of common controls or controls related to centralized activities supports the determination of the nature, timing, and extent of substantive procedures to be performed across the group.

Communications About Significant Matters That Support the Preparation of the Group Financial Statements (Ref: par. 0c(iv))

- A113.** Entities or business units may use a financial reporting framework for legal, regulatory, or other reasons that is different from the financial reporting framework used for the group's financial statements. In such circumstances, an understanding of group management's financial reporting processes to align accounting policies and, when relevant, financial reporting period-ends that differ from that of the group, enables the group auditor to understand how adjustments, reconciliations, and reclassifications are made and whether they are made centrally by group management or by the entity or business unit.

Instructions by Group Management to Entities or Business Units

A114. In applying AU-C section 315,⁶⁵ the group auditor is required to understand how group management communicates significant matters that support the preparation of the group financial statements. To achieve uniformity and comparability of financial information, group management may issue instructions (for example, communicate financial reporting policies) to the entities or business units that include details about financial reporting processes or may have policies that are common across the group. Obtaining an understanding of group management's instructions may affect the identification and assessment of the risks of material misstatement of the group financial statements. For example, inadequate instructions may increase the likelihood of misstatements due to the risk that transactions are incorrectly recorded or processed, or that accounting policies are incorrectly or inconsistently applied.

A115. The group auditor's understanding of the instructions or policies may include the following:

- The clarity and practicality of the instructions for completing the reporting package
- Whether the instructions
 - adequately describe the characteristics of the applicable financial reporting framework and the accounting policies to be applied;
 - address information necessary to prepare disclosures that are sufficient to comply with the requirements of the applicable financial reporting framework, for example, disclosure of related party relationships and transactions, and segment information;
 - address information necessary for making consolidation adjustments, for example, intra-group transactions and unrealized profits, and intra-group account balances; and
 - include a reporting timetable.

Considerations When Component Auditors Are Involved in Understanding the Group and Its Environment, the Applicable Financial Reporting Framework, and the Group's System of Internal Control (Ref: par. 00, 0)

A116. During the course of the group audit, the group auditor may communicate the matters in paragraph 0 to other component auditors, if these matters are relevant to the work of those component auditors. Paragraph 0 includes examples of other matters that may need to be communicated timely in the course of the component auditor's work.

A117. The nature of related party relationships and transactions may, in some circumstances, give

⁶⁵ Paragraph .25b of AU-C section 315.

rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties.⁶⁶ In a group audit, there may be a higher risk of material misstatement of the group financial statements, including due to fraud, associated with related party relationships when

- the group structure is complex;
- the group's information systems are not integrated and therefore less effective in identifying and recording related party relationships and transactions; and
- there are numerous or frequent related party transactions between entities and business units.

Planning and performing the audit with professional skepticism, as required by AU-C section 200,⁶⁷ is therefore particularly important when these circumstances exist.

A118. A component auditor may identify related party relationships or transactions that were not previously identified by group management or the group auditor. The group auditor is required by paragraph 33*b* to communicate to any other component auditors those related party relationships or transactions if they are relevant to the work of the other component auditors.

Identifying and Assessing the Risks of Material Misstatement (Ref: par. 0)

A119. The process to identify and assess the risks of material misstatement of the group financial statements is iterative and dynamic, and may be challenging, particularly when the component's activities are complex or specialized or when there are many components across multiple locations. In applying AU-C section 315,⁶⁸ the auditor develops initial expectations about the potential risks of material misstatement and an initial identification of the significant classes of transactions, account balances, and disclosures of the group financial statements based on their understanding of the group and its environment, the applicable financial reporting framework, and the group's system of internal control.

A120. The initial expectations about the potential risks of material misstatement take into account the auditor's understanding of the group, including its entities or business units, and the environments and industries in which they operate. Based on the initial expectations, the group auditor may, and often will, involve component auditors in risk assessment procedures because they may have direct knowledge and experience with the entities or business units that may be helpful in understanding the activities and related risks, and where risks of material misstatement of the group financial statements may arise in relation to those entities or business units.

A121. For identified risks of material misstatement at the assertion level, the group auditor is

⁶⁶ Paragraph .03 of AU-C section 550.

⁶⁷ Paragraph .17 of AU-C section 200.

⁶⁸ Paragraph .A143 of AU-C section 315.

required to take responsibility for assessing inherent risk. Such assessment involves assessing the likelihood and magnitude of misstatement, which takes into account how, and the degree to which⁶⁹

- inherent risk factors affect the susceptibility of relevant assertions to misstatement.
- the risks of material misstatement at the group financial statement level affect the assessment of inherent risk for risks of material misstatement at the assertion level.

A122. Based on the risk assessment procedures performed, the group auditor may determine that an assessed risk of material misstatement of the group financial statements only arises in relation to financial information of certain components. For example, the risk of material misstatement relating to a legal claim may only exist in entities or business units that operate in a certain jurisdiction or in entities or business units that have similar operations or activities.

A123. Appendix B, “Examples of Events or Conditions That May Give Rise to Risks of Material Misstatement of the Group Financial Statements,” of this proposed SAS sets out examples of events and conditions that, individually or together, may indicate risks of material misstatement of the group financial statements, whether due to fraud or error, including with respect to the consolidation process

Fraud

A124. In applying AU-C section 240,⁷⁰ the auditor is required to identify and assess the risks of material misstatement of the financial statements due to fraud and to design and perform further audit procedures whose nature, timing, and extent are responsive to the assessed risks of material misstatement due to fraud at the assertion level. Information used to identify and assess the risks of material misstatement of the group financial statements due to fraud may include the following:

- Group management’s assessment of the risk that the group financial statements may be materially misstated due to fraud
- Group management’s process for identifying and responding to the risks of fraud in the group financial statements, including any specific fraud risks identified by group management, or classes of transactions, account balances, or disclosures for which a risk of fraud is higher
- Whether there are particular components that are more susceptible to risks of material misstatement due to fraud
- Whether any fraud risk factors or indicators of management bias exist in the

⁶⁹ Paragraph .35 of AU-C section 315.

⁷⁰ Paragraphs .26 and .31 of AU-C section 240.

consolidation process

- How those charged with governance of the group monitor group management's processes for identifying and responding to the risks of fraud in the group, and the controls group management has established to mitigate these risks
- Responses of those charged with governance of the group, group management, appropriate individuals within the internal audit function (and when appropriate, component management, the component auditors, and others) to the group auditor's inquiry whether they have knowledge of any actual, suspected, or alleged fraud affecting a component or the group

Considerations When Component Auditors Are Involved (Ref: par. 36)

A125. When the group auditor involves component auditors in the design and performance of risk assessment procedures, the group auditor remains responsible for having an understanding of the group and its environment, the applicable financial reporting framework, and the group's system of internal control to have a sufficient basis for the identification and assessment of the risks of material misstatement of the group financial statements in accordance with paragraph 35.

A126. When the audit evidence obtained from the risk assessment procedures does not provide an appropriate basis for the identification and assessment of the risks of material misstatement, AU-C section 315⁷¹ requires the auditor to perform additional risk assessment procedures until audit evidence has been obtained to provide such a basis.

Materiality

Component Performance Materiality (Ref: par. 0a)

A127. Paragraph 0a requires the group auditor to determine component performance materiality for each of the components where the group auditor or component auditor will perform audit procedures on financial information that is disaggregated. The component performance materiality amount may be different for each component. Also, the component performance materiality amount for an individual component need not be an arithmetical portion of the group performance materiality and, consequently, the aggregate of component performance materiality amounts may exceed group performance materiality.

A128. This proposed SAS does not require component performance materiality to be determined for components that are audited by referred-to auditors and for which the group auditor plans to make reference to the audit of the referred-to auditor in the auditor's report on the group financial statements.

⁷¹ Paragraph .39 of AU-C section 315.

A129. This proposed SAS does not require component performance materiality to be determined for each class of transactions, account balance, or disclosure for components at which audit procedures are performed. However, if, in the specific circumstances of the group, there is one or more particular classes of transactions, account balances, or disclosures for which misstatements of lesser amounts than materiality for the group financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the group financial statements, AU-C section 320⁷² requires a determination of the materiality level or levels to be applied to those particular classes of transactions, account balances, or disclosures. In these circumstances, the group auditor may need to consider whether a component performance materiality lower than the amount communicated to the component auditor may be appropriate for those particular classes of transactions, account balances, or disclosures.⁷³

A130. The determination of component performance materiality is not a simple mechanical calculation and involves the exercise of professional judgment. Factors the group auditor may take into account in setting component performance materiality include the following:

- The extent of disaggregation of the financial information across components (for example, as the extent of disaggregation across components increases, a lower component performance materiality ordinarily would be appropriate to address aggregation risk). The relative significance of the component to the group may affect the extent of disaggregation (for example, if a single component represents a large portion of the group, there likely may be less disaggregation across components).
- Expectations about the nature, frequency, and magnitude of misstatements in the component financial information, for example
 - whether there are risks that are unique to the financial information of the component (for example, industry-specific accounting matters, unusual or complex transactions).
 - the nature and extent of misstatements identified at the component in prior audits.

A131. To address aggregation risk, paragraph 0a requires component performance materiality to be lower than group performance materiality. As explained in paragraph 0, as the extent of disaggregation across components increases, a lower component performance materiality amount ordinarily would be appropriate to address aggregation risk. In some circumstances, however, component performance materiality may be set at an amount closer to group performance materiality because there is less aggregation risk, such as when the financial information for one component represents a substantial portion of the group financial statements. When determining component performance materiality for a

⁷² Paragraphs .10 and .A13–.A14 of AU-C section 320.

⁷³ Paragraph .A15 of AU-C section 320.

noncontrolling interest in an entity that is accounted for by the equity method, the group auditor may take into account the group's ownership percentage and the share of the investee's profits and losses.

- A132.** In some cases, further audit procedures may be performed by the group auditor or a component auditor on a significant class of transactions or significant account balance as a single population (that is, not disaggregated across components). In such cases, group performance materiality often will be used for purposes of performing these procedures.
- A133.** When the component is subject to an audit required by law or regulation or performed for another reason, the performance materiality used by the component auditor for purposes of such audit ordinarily can be expected to be less than the group performance materiality and, accordingly, the lower component performance materiality would be acceptable for purposes of the group audit.

“Clearly Trivial” Threshold (Ref: par: 0b)

- A134.** The threshold for communicating misstatements to the group auditor is set at an amount equal to, or lower than, the amount regarded as clearly trivial for the group financial statements. In accordance with AU-C section 450,⁷⁴ this threshold is the amount below which misstatements would not need to be accumulated because the group auditor expects that the accumulation of such amounts clearly would not have a material effect on the group financial statements.

Considerations When Component Auditors Are Involved

Communicating Component Performance Materiality (Ref: par. 0)

- A135.** In some cases, it may be appropriate for the group auditor to involve the component auditor in determining an appropriate component performance materiality amount, in view of the component auditor's knowledge of the component and potential sources of misstatement of the component financial information. In this regard, the group auditor also may consider communicating group performance materiality to the component auditor to support collaboration in determining whether component performance materiality, in relation to group performance materiality, is appropriate in the circumstances.
- A136.** Component performance materiality is based, at least in part, on expectations about the nature, frequency, and magnitude of misstatements in the component financial information. Therefore, ongoing communication between the component auditor and the group auditor is important, particularly if the number and magnitude of misstatements identified by the component auditor are higher than expected.

Responding to the Assessed Risks of Material Misstatement (Ref: par. 0)

⁷⁴ Paragraph .A3 of AU-C section 450.

Performing Further Audit Procedures

Performing Further Audit Procedures Centrally

A137. Further audit procedures may be designed and performed centrally if the audit evidence to be obtained from performing further audit procedures on one or more significant classes of transactions, account balances, or disclosures in the aggregate will respond to the assessed risks of material misstatement, for example, if the accounting records for the revenue transactions of the entire group are maintained centrally (for example, at a shared service center). Factors that may be relevant to the auditor's determination of whether to perform further audit procedures centrally include

- the level of centralization of activities relevant to financial reporting,
- the nature and extent of commonality of controls, and
- the similarity of the group's activities and business lines.

A138. The group auditor may determine that the financial information of several components can be considered as one population for the purpose of performing further audit procedures (for example, when transactions are considered to be homogenous because they share the same characteristics, the related risks of material misstatement are the same, and controls are designed and operating in a consistent way).

A139. When further audit procedures are performed centrally, component auditors may still be involved. For example, when the group has multiple shared service centers, the group auditor may involve component auditors in the performance of further audit procedures for these shared service centers.

Performing Further Audit Procedures at the Component Level

A140. In other circumstances, procedures to respond to the risks of material misstatement of the group financial statements that are related to the financial information of a component may be more effectively performed at the component level. This may be the case when the group has

- different revenue streams,
- multiple lines of business,
- operations across multiple locations, or
- decentralized systems of internal control.

Large Number of Components Whose Financial Information Is Individually Immaterial but Material in the Aggregate to the Group Financial Statements

A141. A group may comprise a large number of components whose financial information is

individually immaterial but material in the aggregate to the group financial statements. Circumstances such as these in which the significant classes of transactions, account balances, or disclosures in the group financial statements are disaggregated over a large number of components may present additional challenges for the group auditor in planning and performing further audit procedures.

- A142.** In some cases, it may be possible to obtain sufficient appropriate audit evidence by performing further audit procedures centrally on these significant classes of transactions, account balances, or disclosures (for example, if they are homogeneous, subject to common controls, and access to appropriate information can be obtained). Further audit procedures may also include substantive analytical procedures in accordance with AU-C section 520, *Analytical Procedures*. Depending on the circumstances of the engagement, the financial information of the components may be aggregated at appropriate levels for purposes of developing expectations and determining the amount of any difference of recorded amounts from expected values in performing the substantive analytical procedures. The use of automated tools and techniques may be helpful in these circumstances.
- A143.** In other cases, it may be necessary to perform further audit procedures at selected components to address the risks of material misstatement of the group financial statements. The determination of the components at which audit procedures are to be performed, and the nature, timing, and extent of further audit procedures to be performed at the selected components, are matters of professional judgment. In these circumstances, introducing an element of unpredictability in the components selected for testing also may be helpful in relation to the risks of material misstatement of the group financial statements due to fraud (also see paragraph 0).

The Nature and Extent of Further Audit Procedures

- A144.** In response to the assessed risks of material misstatement, the group auditor may determine the following scope of work to be appropriate at a component (with the involvement of component auditors, as applicable):
- Design and perform further audit procedures on the entire financial information of the component
 - Design and perform further audit procedures on one or more classes of transactions, account balances, or disclosures
 - Perform specific further audit procedures
- A145.** Although the group auditor takes responsibility for the nature, timing, and extent of further audit procedures to be performed, component auditors can be and often are involved in all phases of the group audit, including in the design and performance of further audit procedures.
- A146.** The group auditor may determine that obtaining the audit report of a referred-to auditor

with respect to one or more components may be appropriate audit evidence. In that case, the group auditor follows the requirements in this proposed SAS when making reference to the audit of the referred-to auditor in the auditor's report on the group financial statements.

Design and Perform Further Audit Procedures on the Entire Financial Information of the Component

A147. The group auditor may determine that designing and performing further audit procedures on the entire financial information of a component is an appropriate approach, including when

- audit evidence needs to be obtained on all or a significant proportion of a component's financial information to respond to the assessed risks of material misstatement of the group financial statements.
- there is a pervasive risk of material misstatement of the group financial statements due to the existence of events or conditions at the component that may be relevant to the group auditor's evaluation of group management's assessment of the group's ability to continue as a going concern for a reasonable period of time.

Design and Perform Further Audit Procedures on One or More Classes of Transactions, Account Balances, or Disclosures

A148. The group auditor may determine that designing and performing further audit procedures on one or more particular classes of transactions, account balances, or disclosures of the financial information of a component is an appropriate approach to address assessed risks of material misstatement of the group financial statements. For example, a component may have limited operations but hold a significant portion of the land and buildings of the group or have significant tax balances.

Perform Specific Further Audit Procedures

A149. The group auditor may determine that designing and performing specific further audit procedures on the financial information of a component is an appropriate approach, such as when audit evidence needs to be obtained for one or more relevant assertions only. For example, the group auditor may centrally test the class of transaction, account balance, or disclosure and may require the component auditor to perform specific further audit procedures at the component (for example, specific further audit procedures related to the valuation of claims or litigations in the component's jurisdiction or the existence of an asset).

Element of Unpredictability

A150. Incorporating an element of unpredictability in the type of work to be performed, the entities or business units at which procedures are performed, and the extent to which the

group auditor is involved in the work may increase the likelihood of identifying a material misstatement of the components' financial information that may give rise to a material misstatement of the group financial statements due to fraud.⁷⁵

Operating Effectiveness of Controls

A151. The group auditor may rely on the operating effectiveness of controls that operate throughout the group in determining the nature, timing, and extent of substantive procedures to be performed at either the group level or at the components. AU-C section 330⁷⁶ requires the auditor to design and perform tests of controls to obtain sufficient appropriate audit evidence regarding the operating effectiveness of those controls. Component auditors may be involved in designing and performing such tests of controls.

A152. If deviations from controls upon which the auditor intends to rely are detected, AU-C section 330⁷⁷ requires the auditor to make specific inquiries to understand these matters and their potential consequences. If more deviations than expected are detected as a result of testing the operating effectiveness of the controls, the group auditor may need to revise the group audit plan. Possible revisions to the group audit plan may include the following:

- Performing additional substantive procedures at certain components
- Identifying and testing the operating effectiveness of other relevant controls that are designed and implemented effectively
- Increasing the number of components selected for further audit procedures

A153. When the operating effectiveness of controls is tested centrally (for example, controls at a shared service center or testing of common controls), the group auditor may need to communicate information about the audit work performed to the component auditors. For example, when a component auditor is requested to design and perform substantive procedures on the entire financial information of the component, or design and perform substantive procedures on one or more classes of transactions, account balances, or disclosures, the component auditor may discuss with the group auditor about the control testing performed centrally to determine the nature, timing, and extent of the substantive procedures.

Consolidation Process

Consolidation Procedures (Ref: par. 0a)

A154. Further audit procedures on the consolidation, including sub-consolidations, may include

- determining that the necessary journal entries are reflected in the consolidation, and

⁷⁵ Paragraph .29c of AU-C section 240.

⁷⁶ Paragraph .08 of AU-C section 330.

⁷⁷ Paragraph .17 of AU-C section 330.

- evaluating the operating effectiveness of the controls over the consolidation process and responding appropriately if any controls are determined to be ineffective.

Consolidation Adjustments and Reclassifications (Ref: par. 40b)

A155. The consolidation process may require adjustments and reclassifications to amounts reported in the group financial statements⁷⁸ that do not pass through the usual IT applications and may not be subject to the same controls to which other financial information is subject. The group auditor's evaluation of the appropriateness, completeness, and accuracy of the adjustments and reclassifications may include the following:

- Evaluating whether significant adjustments appropriately reflect the events and transactions underlying them
- Determining whether those entities or business units whose financial information has been included in the group financial statements were appropriately included
- Determining whether significant adjustments have been correctly calculated, processed, and authorized by group management and, when applicable, by component management
- Determining whether significant adjustments are properly supported and sufficiently documented
- Evaluating the reconciliation and elimination of intra-group transactions, unrealized profits or losses, and intra-group account balances

Considerations When Component Auditors Are Involved (Ref: par. 0–0)

A156. When the group auditor involves component auditors in the design or performance of further audit procedures, the component auditor may determine that the use of the work of an auditor's specialist is appropriate and communicate this to the group auditor. In such circumstances, when determining whether the component auditor's design and performance of further audit procedures is appropriate, the group auditor may, for example, discuss the following with the component auditor:

- The nature, scope, and objectives of the auditor's specialist's work
- The component auditor's evaluation of the adequacy of the work of the auditor's specialist for the group auditor's purposes

A157. The appropriate level of the group auditor's involvement may depend on the circumstances

⁷⁸ Paragraph .21b of AU-C section 330.

and the structure of the group and other factors, such as the group auditor's previous experience with the component auditors that perform procedures on the consolidation and sub-consolidations and the circumstances of the group audit engagement (for example, if the financial information of an entity or business unit has not been prepared in accordance with the same accounting policies applied to the group financial statements).

Evaluating the Component Auditor's Communication and the Adequacy of the Component Auditor's Work

Communication About Matters Relevant to the Group Auditor's Conclusion With Regard to the Group Audit (Ref: par. 0)

A158. Although the matters required to be communicated in accordance with paragraph 047 are relevant to the group auditor's conclusion with regard to the group audit, certain matters may be communicated during the course of the component auditor's procedures. In addition to the matters in paragraphs 0 and 0, such matters may include, for example

- information about breaches of relevant ethical requirements, including identified breaches of independence provisions;
- information about instances of noncompliance with laws or regulations;
- newly arising significant risks of material misstatement, including risks of fraud;
- actual, suspected, or alleged fraud involving component management or employees that could have a material effect on the group financial statements;
- significant or unusual transactions; or
- differences of opinion that arise within the component auditor or between the component auditor and the component engagement quality reviewer.

Communication of Misstatements of Component Financial Information (Ref: par. 0e)

A159. Knowledge about corrected and uncorrected misstatements across components may alert the group auditor to potential pervasive control deficiencies, when considered along with the communication of deficiencies in accordance with paragraph 0g. In addition, a higher-than-expected number of identified misstatements (uncorrected or corrected) may indicate a higher risk of undetected misstatements, which may lead the group auditor to conclude that additional audit procedures need to be performed at certain components.

Component Auditor's Overall Findings or Conclusions (Ref: par. 0k)

A160. The form and content of the deliverables from the component auditor are influenced by the nature and extent of the audit work the component auditor has been requested to perform. The group auditor's firm policies or procedures may address the form or specific wording

of an overall conclusion from the component auditor on the audit work performed for purposes of the group audit.

Evaluating Whether Communications With the Component Auditor Are Adequate for the Group Auditor's Purposes (Ref: par. 0b)

A161. If the group auditor determines that the component auditor's communications are not adequate for the group auditor's purposes, the group auditor may consider whether, for example

- further information can be obtained from the component auditor (for example, through further discussions or meetings).
- it is necessary to review additional component auditor audit documentation in accordance with paragraph 0.
- additional audit procedures may need to be performed in accordance with paragraph 0.
- there are any concerns about the component auditor's competence or capabilities.

Reviewing Additional Component Auditor Audit Documentation (Ref: par. 0)

A162. Paragraph 0 provides guidance for the group auditor in tailoring the nature, timing, and extent of the direction and supervision of the component auditor, and the review of their work, based on the facts and circumstances of the group audit and other matters (for example, the assessed risks of material misstatement of the group financial statements). The group auditor's consideration in accordance with paragraph 0c also may be affected by the following matters relevant to the group auditor's ongoing involvement in the work of the component auditor:

- Communications from the component auditor, including those in accordance with paragraph 0 of this proposed SAS
- The review of component auditor audit documentation by the group auditor during the course of the group audit (for example, to fulfill the requirements of paragraphs 0, 0, and 0) or by the group engagement partner in accordance with paragraph 31 of the proposed QM SAS

A163. Other factors that may affect the group auditor's determination about whether, and the extent to which, it is necessary to review additional component auditor audit documentation in the circumstances include the following:

- The degree to which the component auditor was involved in risk assessment procedures and in the identification and assessment of the risks of material misstatement of the group financial statements

- The significant judgments made by, and the findings or conclusions of, the component auditor about matters that are material to the group financial statements
- The competence and capabilities of more experienced engagement team members from the component auditor responsible for reviewing the work of less experienced individuals
- Whether the component auditor and group auditor are subject to common policies or procedures for review of audit documentation

Considerations Regarding Making Reference to the Audit of a Referred-to Auditor in the Auditor’s Report on the Group Financial Statements

A164. The requirements in paragraphs 0–0 and the related application material in paragraphs 0–0 apply only when the group engagement partner plans to obtain audit evidence through making reference to the audit of a referred-to auditor in the auditor’s report on the group financial statements. (Ref: Exhibit A, “Relevancy of Requirements in Various Group Audit Scenarios.”)

Understanding the Referred-to Auditor

Relevant Ethical Requirements, Including Those Related to Independence, for Referred-to Auditors (Ref: par. 0)

A165. When the group engagement partner determines to make reference to the audit of a referred-to auditor in the auditor’s report on the group financial statements, the referred-to auditor is subject to ethical requirements, including those related to independence, that are relevant to the group audit. Such requirements may be different or in addition to those applying to a referred-to auditor when performing an audit on the financial statements of an entity or business unit that is part of the group for legal, regulatory, or other reasons in the referred-to auditor’s jurisdiction. When the referred-to auditor is not subject to the AICPA Code of Professional Conduct, compliance by the referred-to auditor with the ethics and independence requirements set forth in the International Federation of Accountants Code of Ethics for Professional Accountants is sufficient to fulfill the referred-to auditor’s ethical responsibilities in the group audit.

Competence and Capabilities of Referred-to Auditors (Ref: par. 00)

A166. Determining whether referred-to auditors have the appropriate competence and capabilities is a matter of professional judgment and is influenced by the nature and circumstances of the group audit engagement.

A167. In determining whether referred-to auditors have the appropriate competence and capabilities, the group engagement partner may consider matters such as the following:

- Previous experience with or knowledge of the referred-to auditor
- The referred-to auditor's specialized skills (for example, industry-specific knowledge or knowledge of relevant financial reporting requirements for statements and schedules to be filed with regulatory agencies)
- The referred-to auditor's understanding of the auditing and other standards applicable to the group audit that is sufficient to fulfill the referred-to auditor's responsibilities
- Whether a referred-to auditor operates in a regulatory environment that actively oversees auditors

A168. The procedures to determine the referred-to auditor's competency and capability may include, for example, the following:

- Requesting the referred-to auditor to confirm the matter referred to in paragraph 0 in writing
- Obtaining published external inspection reports, peer review reports on the referred-to auditor's firm, and other relevant publicly available information relating to the professional reputation and standing of a referred-to auditor

A169. If there has been a breach by a referred-to auditor of the relevant ethical requirements that apply to the group audit engagement, including those related to independence, and the breach has not been satisfactorily addressed in accordance with provisions of the relevant ethical requirements, the group auditor cannot make reference in the auditor's report on the group financial statements to the audit of the referred-to auditor. The group auditor also cannot use the work of that auditor in the capacity of a component auditor as described by this proposed SAS.

A170. Serious concerns are those concerns that in the group auditor's professional judgment cannot be overcome. The group engagement partner may be able to overcome less-than-serious concerns about the referred-to auditor's professional competency or the fact that the referred-to auditor does not operate in an environment that actively oversees auditors, by, for example, the group auditor directly performing further audit procedures on the financial information of the component.

Determining Whether to Make Reference to the Audit of a Referred-to Auditor (Ref: par. 0–0)

A171. The group engagement partner determines, individually for each component, whether to

- be involved in the work of the component auditor, insofar as that work relates to the expression of an audit opinion on the group financial statements, or

- make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements.

A172. In group audits with two or more components, the decision to make reference is made individually for each potential referred-to auditor. The group auditor may make reference to any, all, or none of the potential referred-to auditors. For example, if one component is audited by an auditor from a network firm and another component is audited by a non-network firm, the group engagement partner may decide to be involved in the work of the auditor from the network firm and to make reference to the work of the auditor from the non-network firm.

A173. The determination of whether to be involved in the work of the component auditor or make reference to the audit of a referred-to auditor may include factors related to the group being audited or factors related to the performance of audit procedures for the group audit. Factors that may affect the group engagement partner's determination of whether to make reference to the audit of a potential referred-to auditor in the auditor's report on the group financial statements include the following:

- The group auditor's understanding of the group and its environment and the group's system of internal control
- Differences in the financial reporting framework applied in preparing the financial statements of the component and that applied in preparing the group financial statements
- Whether the audit of the financial statements of the component will be completed in time to meet the group reporting timetable
- Differences in the auditing and other standards applied by the potential referred-to auditor and those applied in the audit of the group financial statements
- Whether it is impracticable for the group auditor to be involved in the audit of the component financial statements

Determining Whether the Audit of the Referred-to Auditor Was Conducted in Accordance With GAAS (Ref: par. 0a)

A174. An auditor's report stating that the audit was conducted in accordance with GAAS or, if applicable, the auditing standards promulgated by the PCAOB is sufficient to make the determination required by paragraph 0a.⁷⁹ When the auditor has performed an audit of the component financial statements in accordance with auditing standards other than GAAS or, if applicable, the auditing standards promulgated by the PCAOB, the group engagement partner may evaluate, exercising professional judgment, whether the audit performed by the auditor meets the relevant requirements of GAAS. For the purposes of complying with

⁷⁹ Paragraphs .44-.46 of AU-C section 700, *Forming an Opinion and Reporting on Financial Statements*.

paragraph 0a, relevant requirements of GAAS are those that pertain to planning and performing the audit of the component financial statements and do not include those related to the form of the auditor's report. Audits performed in accordance with International Standards on Auditing (ISAs) promulgated by the International Auditing and Assurance Standards Board (IAASB) are more likely to meet the relevant requirements of GAAS than audits performed in accordance with auditing standards promulgated by bodies other than the IAASB. The group auditor may provide the referred-to auditor with AU-C Appendix B, "Substantive Differences Between the International Standards on Auditing and Generally Accepted Auditing Standards," that identifies substantive requirements of GAAS that are not requirements in the ISAs. The referred-to auditor may perform additional procedures in order to meet the relevant requirements of GAAS. The communication requested of the referred-to auditor required by paragraphs 0-0 may address whether the audit met the relevant requirements of GAAS. The group engagement partner, having determined that all relevant requirements of GAAS have been met by the referred-to auditor, may decide to make reference to the audit of that referred-to auditor in the auditor's report on the group financial statements.

Determining Whether to Make Reference to the Audit of a Referred-to Auditor When the Financial Reporting Framework Is Not the Same (Ref: par. 0)

- A175.** When the component's financial statements are prepared using a financial reporting framework that differs from the financial reporting framework used to prepare the group financial statements, the group auditor is required by this proposed SAS to evaluate whether the financial information of the component has been appropriately adjusted for purposes of the preparation and fair presentation of the group financial statements in accordance with the applicable financial reporting framework. Evaluating whether the financial statements of the component have been appropriately adjusted to conform with the financial reporting framework used by the group is based on a depth of understanding of the component's financial statements that ordinarily is not obtained unless the group auditor is involved in the audit of the component financial statements. In rare circumstances, however, the group engagement partner may conclude that the group auditor can reasonably expect to obtain sufficient appropriate audit evidence for purposes of evaluating the appropriateness of the adjustments to convert the component's financial statements to the financial reporting framework used by the group without the need to be involved in the audit of the component financial statements.
- A176.** The greater the number of differences or the greater the significance of the differences between the criteria used for measurement, recognition, presentation, and disclosure of material items in the component's financial statements under the financial reporting framework used by the component and the financial reporting framework used by the group, the less similar they are. Financial statements prepared and presented in accordance with International Financial Reporting Standards (IFRSs) and International Financial Reporting Standards for Small and Medium-Sized Entities, as issued by the International Accounting Standards Board, are generally viewed as more similar to financial statements prepared and presented in accordance with accounting principles generally accepted in the United States of America (GAAP) than financial statements prepared and presented in

accordance with jurisdiction-specific reporting frameworks or adaptations of IFRSs. In most cases, special purpose frameworks set forth in AU-C section 800, *Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, are not similar to GAAP.⁸⁰

A177. When the component prepares financial statements using a different financial reporting framework than that used by the group, additional considerations in determining whether it may be appropriate to make reference to the audit of a potential referred-to auditor in the auditor's report on the group financial statements include the following:

- The effectiveness of controls related to financial reporting and the adequacy of the consolidation process specifically related to the adjustments to convert the component's financial statements to the financial reporting framework used by the group, including the financial reporting competencies of personnel involved in the adjustments
- The depth of the group auditor's understanding of the component and its environment, including the complexity of the events and transactions subject to the differing financial reporting requirements and the assessed risk of material misstatement related to the adjustments
- The extent of the group auditor's knowledge of the financial reporting framework used to prepare the component financial statements
- The group auditor's ability to obtain information from group or component management that is relevant to the adjustments
- The need and ability to seek, as necessary, the assistance of professionals possessing specialized skills or knowledge related to the adjustments

Considerations for Governmental Entities

A178. When the applicable financial reporting framework used by the group provides for the inclusion of component financial statements that are prepared in accordance with a different financial reporting framework, the component financial statements are deemed to be in accordance with the applicable financial reporting framework used for the group financial statements. For example, both the financial reporting framework established by GASB and the financial reporting framework established by the Federal Accounting Standards Advisory Board have such provisions. Accordingly, when the provisions established by the applicable financial reporting framework for inclusion of those component financial statements have been followed, the requirements in paragraphs 0 and 0c are not relevant.

⁸⁰ Paragraph .06 of AU-C section 700.

Making Reference to the Audit of a Referred-to Auditor (Ref: par. 0–0)

- A179.** Reference in the auditor’s report on the group financial statements to the fact that part of the audit was conducted by a referred-to auditor is not to be construed as a qualification of the opinion but, rather, is intended to communicate (a) that the group auditor was not involved in the work of the referred-to auditor, and (b) the source of the audit evidence with respect to those components for which reference to the audit of referred-to auditors is made.
- A180.** The disclosure of the magnitude of the portion of the financial statements audited by a referred-to auditor may be achieved by stating the dollar amounts or percentages of one or more of the following: total assets, total revenues, or other appropriate criteria, whichever most clearly describes the portion of the financial statements audited by a referred-to auditor. When two or more referred-to auditors are referred to, the dollar amounts or percentages covered by the referred-to auditors may be stated in the aggregate.
- A181.** Exhibit B contains examples of appropriate reporting in the auditor’s report on the group financial statements when reference is made to the audit of a referred-to auditor in the auditor’s report on the group financial statements.
- A182.** If there is a modified opinion, emphasis-of-matter paragraph, other-matter paragraph, or Going Concern section in the referred-to auditor’s report, but it does not affect the report on the group financial statements and the referred-to auditor’s report is not presented, the group auditor need not make reference to those paragraphs or that section in the auditor’s report on the group financial statements. If the referred-to auditor’s report is presented, the group auditor may make reference to those paragraphs or that section and their disposition.

Communications With the Referred-to Auditor (Ref: par. 0–0)

- A183.** The form of the communications between the group auditor and referred-to auditors may vary and may not necessarily be in writing. However, verbal communications between the group auditor and referred-to auditors may be supplemented by written communication, such as the group auditor obtaining written representations from the referred-to auditor confirming that the referred-to auditor has complied with the ethical requirements that are relevant to the group audit engagement, including independence, or communicating matters related to the referred-to auditor’s competence and capabilities.
- A184.** The referred-to auditor may identify related party relationships or transactions that were not previously identified by group management or the group auditor. The group auditor is required by paragraph 0b to communicate to any other referred-to auditors those related party relationships or transactions if they are relevant to the work of the other referred-to auditors.

Subsequent Events (Ref: par. 0–0)

A185. When component auditors are involved, the group auditor may

- request a component auditor to perform subsequent events procedures to assist the group auditor to identify events that occur between the dates of the financial information of the components and the date of the auditor's report on the group financial statements.
- perform procedures to cover the period between the date of communication of subsequent events by the component auditor and the date of the auditor's report on the group financial statements, if applicable.

A186. When the group engagement partner determines to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements, procedures designed to identify subsequent events between the date of the referred-to auditor's report and the date of the auditor's report on the group financial statements may include the following:

- Obtaining an understanding of any procedures that group management has established to ensure that such subsequent events are identified
- Requesting the referred-to auditor to update subsequent events procedures to the date of the auditor's report on the group financial statements
- Requesting specific written representations from component management regarding subsequent events
- Reading available interim financial information of the component and making inquiries of group management
- Reading minutes of meetings of the governing board, or any other administrative board with management oversight, held since the financial statement date
- Reading the subsequent year's capital and operating budgets
- Inquiring of group management regarding currently known facts, decisions, or conditions that are expected to have a significant effect on financial position or results of operations for items that represent subsequent events

A187. In applying AU-C section 330, if the group auditor is unable to obtain sufficient appropriate audit evidence, including with regard to subsequent events that require adjustment of, or disclosure in, the group financial statements, the auditor is required to express a qualified

opinion or disclaim an opinion on the financial statements.⁸¹

Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained

Sufficiency and Appropriateness of Audit Evidence (Ref: par. 0)

A188. The audit of group financial statements is a cumulative and iterative process. As the group auditor performs planned audit procedures, the audit evidence obtained may cause the group auditor to modify the nature, timing, or extent of other planned audit procedures because information may come to the group auditor's attention that differs significantly from the information on which the risk assessment was based, for example

- the misstatements identified at a component may need to be considered in relation to other components, or
- the group auditor may become aware of access restrictions to information or people at a component because of changes in the environment (for example, war, civil unrest, or outbreaks of disease).

In such circumstances, the group auditor may need to reevaluate the planned audit procedures, based on the revised consideration of assessed risks for all or some of the significant classes of transactions, account balances, or disclosures and related relevant assertions.

A189. The evaluation required by paragraph 0 assists the group auditor in determining whether the overall group audit strategy and group audit plan developed to respond to the assessed risks of material misstatement of the group financial statements continues to be appropriate. The requirement in AU-C section 330⁸² for the auditor, irrespective of the assessed risks of material misstatement, to design and perform substantive procedures for each relevant assertion of each significant class of transactions, account balance, and disclosure also may be helpful for purposes of this evaluation in the context of the group financial statements.

A190. The group auditor may consider the engagement team's maintenance of professional skepticism when evaluating the sufficiency and appropriateness of audit evidence obtained. For example, the group auditor may consider whether matters such as those described in paragraph 0 have inappropriately led the engagement team to

- obtain audit evidence that is easier to access without giving appropriate consideration to its relevance and reliability,
- obtain less persuasive evidence than is necessary in the circumstances, or

⁸¹ Paragraphs .08–.10 of AU-C section 705, *Modifications to the Opinion in the Independent Auditor's Report*, address qualified, adverse, and disclaimer of opinions.

⁸² Paragraph .18 of AU-C section 330.

- design and perform audit procedures in a manner that is biased towards obtaining evidence that is corroborative or excluding evidence that is contradictory.

A191. The proposed QM SAS⁸³ requires the engagement partner to determine, on or before the date of the auditor's report, through review of audit documentation and discussion with the engagement team, that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued. Information that may be relevant to the group auditor's evaluation of the audit evidence obtained from the work performed by component auditors or through making reference to the audit of referred-to auditors in the auditor's report on the group financial statements depends on the facts and circumstances of the group audit, and may include the following:

- Communications from the component auditors required by paragraph 0, including the overall findings or conclusions of the component auditors on the work performed for purposes of the group audit
- Other communications from the component auditors throughout the group audit, including those required by paragraph 0
- The group auditor's direction and supervision of the component auditors, and review of their work, including, as applicable, the group auditor's review of additional component auditor audit documentation in accordance with paragraph 0
- The referred-to auditor's report on the component's financial statements, including, as applicable, if the opinion of a referred-to auditor is modified or if that report includes an emphasis-of-matter paragraph, an other-matter paragraph, or a Going Concern section
- Communications from the referred-to auditors required by this proposed SAS

A192. In some circumstances, an overall summary memorandum describing the work performed and the results thereof may provide a basis on its own for the group auditor to conclude that the work performed and audit evidence obtained by the component auditor is sufficient for purposes of the group audit. This may be the case, for example, when the component auditor has been requested to perform specific further audit procedures as identified and communicated by the group auditor.

Evaluating the Effect on the Group Audit Opinion (Ref: par. 0)

A193. The group engagement partner's evaluation may include a consideration of whether corrected and uncorrected misstatements communicated by component auditors indicate a systemic issue (for example, regarding transactions subject to common accounting policies or common controls) that may affect other components.

⁸³ Paragraph 32 of the proposed QM SAS.

Auditor's Report

Considerations When Component Auditors Are Involved (Ref: par. 0)

- A194.** When component auditors are involved in the group audit, no reference is made to the component auditor in the auditor's report on the group financial statements because to do so may cause a reader to misinterpret the degree of responsibility of the group auditor.
- A195.** When the group audit opinion is modified because the group auditor was unable to obtain sufficient appropriate audit evidence in relation to the financial information of one or more components, the Basis for Qualified Opinion or Basis for Disclaimer of Opinion section in the auditor's report on the group financial statements describes the reasons for that inability. In some circumstances, the group auditor may decide a reference to a component auditor or referred-to auditor is necessary to adequately describe the reasons for the modified opinion, for example, when the component auditor is unable to perform or complete the work requested on the component financial information due to circumstances beyond the control of component management.

Communication With Group Management and Those Charged With Governance of the Group

Communication With Group Management (Ref: par. 0–0)

- A196.** The group audit may be complex due to the number and nature of the entities and business units comprising the group. In addition, as explained in paragraph 0, the group auditor may determine that certain entities or business units may be considered together as a component for purposes of planning and performing the group audit. Therefore, discussing with group management an overview of the planned scope and timing may help in coordinating the work performed at components, including when component auditors are involved or reference is made to the audit of referred-to auditors in the auditor's report on the group financial statements, and in identifying component management (see paragraph 0).
- A197.** AU-C section 240⁸⁴ contains requirements and guidance on the communication of fraud to management and, when management may be involved in the fraud, to those charged with governance.
- A198.** Group management may need to keep certain material sensitive information confidential. Examples of matters that may be significant to the financial statements of the component of which component management may be unaware include the following:

- Potential litigation
- Plans for abandonment of material operating assets
- Subsequent events

⁸⁴ Paragraphs .40–.42 of AU-C section 240.

- Significant legal agreements

A199. Group management may inform the group auditor about noncompliance or suspected noncompliance with laws or regulations in entities or business units within the group. Paragraph A96 provides guidance for the group engagement partner in these circumstances.

Communication With Those Charged With Governance of the Group (Ref: par. 0)

A200. The matters the group auditor communicates to those charged with governance of the group may include those brought to the attention of the group auditor by component auditors or referred-to auditors that the group auditor judges to be significant to the responsibilities of those charged with governance of the group. Communication with those charged with governance of the group may take place at various times during the group audit. For example, the matter referred to in paragraph 0a may be communicated after the group auditor has determined the work to be performed on the financial information of the components. On the other hand, the matter referred to in paragraph 0b may be communicated at the end of the audit, and the matters referred to in paragraph 0c–d may be communicated when they occur.

A201. AU-C section 260⁸⁵ requires the auditor to communicate with those charged with governance an overview of the planned scope and timing of the audit. For a group audit, this communication helps those charged with governance understand the group auditor’s determination of the components at which audit work will be performed, including whether certain of the group’s entities or business units will be considered together as a component, the planned involvement of component auditors, and the basis for the decision to make reference to the audit of a referred-to auditor in the auditor’s report on the group financial statements. This communication also helps to enable a mutual understanding of and discussion about the group and its environment (see paragraph 0) and areas, if any, in which those charged with governance may request the group auditor to undertake additional procedures.

Communication of Identified Deficiencies in Internal Control (Ref: par. 0)

A202. The group auditor is responsible for determining, on the basis of the audit work performed, whether one or more identified deficiencies, individually or in combination, constitute significant deficiencies or material weaknesses.⁸⁶ The group auditor may request input from the component auditor about whether an identified deficiency or combination of deficiencies at the component is a significant deficiency or material weakness in internal control.

Documentation (Ref: par. 0)

⁸⁵ Paragraph .11 of AU-C section 260.

⁸⁶ Paragraph .09 of AU-C section 265.

A203. Other AU-C sections contain specific documentation requirements that are intended to clarify the application of AU-C section 230 in the particular circumstances of those other AU-C sections. The appendix to AU-C section 230 lists other AU-C sections that contain specific documentation requirements and guidance.

A204. The audit documentation for the group audit supports the group auditor's evaluation in accordance with paragraph 0 about whether sufficient appropriate audit evidence has been obtained on which to base the group audit opinion. Also see paragraph 0.

A205. The audit documentation for the group audit comprises

- the documentation in the group auditor's file, and
- the separate documentation in the respective component auditor files relating to the work performed by the component auditors for purposes of the group audit (that is, component auditor audit documentation).

A206. The final assembly and retention of the audit documentation for a group audit is subject to the policies or procedures of the group auditor's firm in accordance with proposed SQMS No. 1.⁸⁷ The group auditor may provide specific instructions to component auditors regarding the assembly and retention of the documentation of work performed by them for purposes of the group audit.

Basis for the Group Auditor's Determination of Components (Ref: par: 0b)

A207. The basis for the group auditor's determination of components may be documented in various ways, including, for example, documentation related to the fulfillment of the requirements in paragraphs 0, 0, and 0a of this proposed SAS.

Basis for the Group Auditor's Determination of the Competence and Capabilities of Component Auditors (Ref: par: 0d)

A208. Proposed SQMS No. 1⁸⁸ provides guidance on matters that the firm's policies or procedures may address regarding the competence and capabilities of the engagement team members. Such policies or procedures may describe or provide guidance about how to document the determination of the competence and capabilities of the engagement team, including component auditors. For example, the confirmation obtained from the component auditor in accordance with paragraph 0 may include information about the component auditor's relevant industry experience. The group auditor also may ask for confirmation that the component auditor has sufficient time to perform the assigned audit procedures (see paragraph 0).

Documentation of the Direction and Supervision of Component Auditors and the Review of Their

⁸⁷ Paragraphs 32f and A87–A89 of proposed SQMS No. 1.

⁸⁸ Paragraph A100 of proposed SQMS No. 1.

Work (Ref: Par. 0f)

A209. As described in paragraph 0, the approach to direction, supervision, and review in a group audit will be tailored by the group auditor based on the facts and circumstances of the engagement and will generally include a combination of addressing the group auditor's firm policies or procedures and responses specific to the group audit. Such policies or procedures may also describe or provide guidance about the documentation of the group auditor's direction and supervision of the engagement team and the review of their work.

A210. AU-C section 300⁸⁹ requires the auditor to develop an audit plan that includes a description of the nature, timing, and extent of the planned direction and supervision of engagement team members and the review of their work. When component auditors are involved, the extent of such descriptions will often vary by component, recognizing that the planned nature, timing, and extent of direction and supervision of component auditors, and review of their work, may be influenced by the matters described in paragraph 0.

A211. The group auditor's documentation of the direction and supervision of component auditors and the review of their work may include, for example, the following:

- Required communications with component auditors, including any instructions issued and other confirmations required by this proposed SAS.
- The rationale for the selection of visits to component auditor sites, attendees at meetings, and the nature of the matters discussed.
- Matters discussed in meetings with component auditors or component management.
- The rationale for the group auditor's determination of component auditor audit documentation selected for review.
- Changes in the planned nature and extent of involvement with component auditors and the reasons why. This may include circumstances in which the group auditor modified the nature, timing, or extent of the direction and supervision of the component auditors, and the review of their work, in areas of the audit that are more complex or subjective than initially anticipated.

A212. Paragraph 0 requires the group auditor to determine whether, and the extent to which it is necessary, to review additional component auditor audit documentation. Paragraphs 0–0 provide guidance for the group auditor in making this determination.

A213. Component auditor audit documentation ordinarily need not be replicated in the group auditor's audit file. However, the group auditor may decide to summarize, replicate, or retain copies of certain component auditor documentation in the group auditor's audit file

⁸⁹ Paragraph .09 of AU-C section 300.

to supplement the description of a particular matter in communications from the component auditor, including the matters required to be communicated by this proposed SAS. Examples of such component auditor documentation may include

- a listing or summary of the significant judgments made by the component auditor, and the conclusions reached thereon, that are relevant to the group audit,
- matters that may need to be communicated to those charged with governance of the group, or
- matters that may be determined to be key audit matters to be communicated in the auditor's report on the group financial statements, when engaged to do so.

A214. When required by law or regulation, certain component auditor documentation may need to be included in the group auditor's audit file, for example, to respond to the request of a regulatory authority to review documentation related to work performed by a component auditor.

A215. Policies or procedures established by the firm in accordance with the firm's system of quality management, or resources provided by the firm or a network, may assist the group auditor in documenting the direction and supervision of component auditors and the review of their work. For example, an electronic audit tool may be used to facilitate communications between the group auditor and component auditors. The electronic audit tool also may be used for audit documentation, including providing information about the reviewers and the dates and extent of their review.

Additional Considerations When Access to Component Auditor Audit Documentation Is Restricted
(Ref: par. 59)

A216. Audit documentation for a group audit may present some additional complexities or challenges in certain circumstances. This may be the case, for example, when law or regulation restrict the component auditor from providing documentation outside of its jurisdiction, or when war, civil unrest, or outbreaks of disease restrict access to relevant component auditor audit documentation.

A217. The group auditor may be able to overcome such restrictions by, for example

- visiting the location of the component auditor, or meeting with the component auditor in a location different from where the component auditor is located, to review the component auditor's audit documentation;
- reviewing the relevant audit documentation remotely through the use of technology, when not prohibited by law or regulation;
- requesting the component auditor to prepare and provide a memorandum that addresses the relevant information and holding discussions with the component

auditor, if necessary, to discuss the contents of the memorandum; or

- discussing with the component auditor the procedures performed, the evidence obtained, and the conclusions reached by the component auditor.

It is a matter of professional judgment whether one or more of the preceding actions may be sufficient to overcome the restrictions depending on the facts and circumstances of the group audit.

A218. When access to component auditor audit documentation is restricted, the group auditor's documentation nonetheless needs to comply with the requirements of GAAS, including those relating to the documentation of the nature, timing, and extent of the group auditor's direction and supervision of component auditors and the review of their work. The guidance in paragraphs 0–0 may be helpful in determining the extent of the group auditor's review of the component auditor audit documentation in these circumstances. Paragraphs 0 and 0 provide examples of circumstances in which certain component auditor audit documentation may be included in the group auditor's audit file.

A219. If the group auditor is unable to overcome restrictions on access to the component auditor audit documentation, the group auditor may need to consider whether a scope limitation exists that may require a modification to the opinion on the group financial statements. See paragraph 0.

A220.

Exhibit A — Relevancy of Requirements in Various Group Audit Scenarios (Ref: par.0 0a, 0)

The requirements of this proposed Statement on Auditing Standards (SAS) are intended to be applied in the context of the nature and circumstances of each group audit. The following are various scenarios related to how a group audit may be carried out. Depending on the involvement of component auditors or whether reference is made to the audit of a referred-to auditor in the auditor’s report on the group financial statements, certain requirements in this proposed SAS may not be relevant due to their conditionality. The following table provides examples of the requirements in this proposed SAS that are relevant for various group audit scenarios.

Regardless of the scenario, as required by paragraph .21 of AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, the group auditor is required to have an understanding of the entire text of this proposed SAS, including its application and other explanatory material, to understand its objectives and apply its requirements properly.

Group Audit Scenario	Relevant Requirements
<p>Scenario 1 – Group Auditor <i>The group audit is carried out entirely by the group auditor.</i></p>	<ul style="list-style-type: none"> • Paragraphs 12–24 • Paragraph 32 • Paragraphs 35–37 • Paragraphs 39–42 • Paragraph 66 • Paragraphs 68–69 • Paragraphs 71–72 • Paragraphs 74–76
<p>Scenario 2 – Group Auditor and Component Auditors <i>Component auditors are involved in the group audit.</i></p>	<ul style="list-style-type: none"> • Paragraphs 12–50 • Paragraphs 66–76
<p>Scenario 3 – Group Auditor and Referred-to Auditors <i>The group auditor makes reference to the audit of a referred-to auditor in the auditor’s report on the group financial statements.</i></p>	<ul style="list-style-type: none"> • Paragraphs 12–24 • Paragraph 32 • Paragraphs 35–37 • Paragraphs 39–42 • Paragraphs 51–66 • Paragraphs 68–69

Group Audit Scenario	Relevant Requirements
	<ul style="list-style-type: none"> • Paragraphs 71–76
<p>Scenario 4 – Group Auditor, Component Auditors, and Referred-to Auditor</p> <p><i>Component auditors are involved in the group audit, and the group auditor makes reference to the audit of a referred-to auditor in the auditor’s report on the group financial statements.</i></p>	<ul style="list-style-type: none"> • Paragraphs 12–76

A221.

Exhibit B — Illustrative Auditor’s Reports on Group Financial Statements (Ref: par. 0)

Illustration 1: Independent Auditor’s Report With a Qualified Opinion When the Group Auditor Is Not Able to Obtain Sufficient Appropriate Audit Evidence on Which to Base the Group Auditor’s Opinion

Circumstances include the following:

- Audit of a complete set of consolidated general purpose financial statements.
- Management is responsible for the preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by FASB.
- The terms of the audit engagement reflect the description of management’s responsibility for the consolidated financial statements in AU-C section 210, *Terms of Engagement*.
- The group auditor is unable to obtain sufficient appropriate audit evidence relating to a component accounted for by the equity method because the group auditor was unable to obtain the audited financial statements of the component as of December 31, 20X1 and 20X0, including the auditor’s report thereon. In this example, the auditor of the group financial statements is not making reference to the report of a referred-to auditor. In the auditor’s professional judgment, the effect on the group financial statements of this inability to obtain sufficient appropriate audit evidence is material but not pervasive. Accordingly, the auditor’s report contains a qualified opinion.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events considered in the aggregate that raise substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time in accordance with AU-C section 570, *The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern*.
- The auditor has not been engaged to communicate key audit matters in accordance with AU-C section 701, *Communicating Key Audit Matters in the Independent Auditor’s Report*.
- The auditor has obtained all the other information prior to the date of the auditor’s report, and the qualified opinion on the consolidated financial statements also affects the other information included in the annual report.

Independent Auditor’s Report

[Appropriate Addressee]

Report on the Audit of the Consolidated Financial Statements¹

Qualified Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries (the Group), which comprise the consolidated statement of financial position as of December 31, 20X1, and the related consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and the related notes to the consolidated financial statements.

In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion section of our report, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as of December 31, 20X1, and (of) its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Qualified Opinion

We were unable to obtain audited financial statements supporting the Company's investment in a foreign affiliate stated at \$_____ and \$__ at December 31, 20X1 and 20X0, respectively, or its equity in earnings of that affiliate of \$___ and \$__, which is included in net income for the years then ended as described in Note X to the consolidated financial statements; nor were we able to satisfy ourselves as to the carrying value of the investment in the foreign affiliate or the equity in its earnings by other auditing procedures.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are required to be independent of ABC Company and its subsidiaries and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of

¹ The subtitle, "Report on the Audit of the Consolidated Financial Statements," is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.²
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control–related matters that we identified during the audit.

Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[Reporting in accordance with the reporting requirements in AU-C section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports, for when there is a qualified opinion due to limitation of scope.]

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of auditor's firm]

[City and state where the auditor's report is issued]

² In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

[Date of the auditor's report]

Illustration 2: A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Referred-to Auditor in Accordance With Generally Accepted Auditing Standards

Circumstances include the following:

- Audit of a complete set of consolidated general purpose financial statements (comparative).
- Management is responsible for the preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by FASB.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in AU-C section 210, *Terms of Engagement*.
- The auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using the same financial reporting framework as that used for the group financial statements and performed by a referred-to auditor in accordance with generally accepted auditing standards (GAAS).
- The auditor has concluded that an unmodified (that is, "clean") opinion is appropriate based on the audit evidence obtained.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has obtained all the other information prior to the date of the auditor's report and has not identified an uncorrected material misstatement of the other information included in the annual report.
- The auditor has not been engaged to communicate key audit matters.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Consolidated Financial Statements¹

Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, based on our audits and the report of the other auditors, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

We did not audit the financial statements of B Company, a wholly owned subsidiary, whose statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of the other auditors.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted

¹ The subtitle, "Report on the Consolidated Financial Statements," is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.²
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control–related matters that we identified during the audit.

Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[Reporting in accordance with the reporting requirements in AU-C section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports.]

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

² In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

Illustration 3: A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using a Different Financial Reporting Framework From That Used for the Group Financial Statements and Performed by a Referred-to Auditor in Accordance With GAAS

Circumstances are the same as in illustration 2, except in this example, the auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using a different financial reporting framework than that used for the group financial statements and performed by a referred-to auditor in accordance with GAAS.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Consolidated Financial Statements¹

Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, based on our audits and the report of the other auditors, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

We did not audit the financial statements of B Company, a wholly owned subsidiary, whose statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements, which were prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, were audited by other auditors, whose report has been furnished to us. We have applied audit procedures on the conversion adjustments to the financial statements of B Company, which conform those financial statements to accounting principles generally accepted in the United States of America. Our opinion, insofar as it relates to the amounts included for B Company, prior to these conversion adjustments, is based solely on the report of the other auditors.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical

¹ The subtitle, "Report on the Consolidated Financial Statements," is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.²
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.

² In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control–related matters that we identified during the audit.

Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[Reporting in accordance with the reporting requirements in section AU-C section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports.]

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

Illustration 4: A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Referred-to Auditor in Accordance With Auditing Standards Other Than GAAS

Circumstances are the same as in illustration 2, except in this example, the auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using the same financial reporting framework as that used for the group financial statements and performed by a referred-to auditor in accordance with auditing standards other than GAAS or standards promulgated by the PCAOB. The group engagement partner has determined that the referred-to auditor performed additional audit procedures to meet the relevant requirements of GAAS. If additional procedures were not necessary for the audit of the referred-to auditor to meet the relevant requirements of GAAS, illustration 2 is applicable.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Consolidated Financial Statements¹

Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, based on our audits and the report of and additional audit procedures performed by the other auditors, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

We did not audit the financial statements of B Company, a wholly owned subsidiary, whose statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements were audited by other auditors in accordance with [*describe the set of auditing standards*], whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of and additional audit procedures to meet the relevant requirements of auditing standards generally accepted in the United States of America performed by the other auditors.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error. In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

¹ The subtitle, "Report on the Consolidated Financial Statements," is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.²
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control–related matters that we identified during the audit.

Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[Reporting in accordance with the reporting requirements in AU-C section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports.]

² In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

Appendix A — Understanding the Group’s System of Internal Control (Ref: par. 0)

1. This appendix provides examples of matters related to internal control that may be helpful in obtaining an understanding of the system of internal control in the context of a group environment and expands on how AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*,¹ is to be applied in relation to an audit of group financial statements. The examples may not be relevant to every group audit engagement, and the list of examples is not necessarily complete.

Control Environment

2. The group auditor’s understanding of the control environment may include matters such as the following:
 - The structure of the governance and management functions across the group, and group management’s oversight responsibilities, including arrangements for assigning authority and responsibility to management of entities or business units in the group
 - How oversight over the group’s system of internal control by those charged with governance is structured and organized
 - How ethical and behavioral standards are communicated and reinforced in practice across the group (for example, group-wide programs, such as codes of conduct and fraud prevention programs)
 - The consistency of policies and procedures across the group, including a group financial reporting procedures manual

The Group’s Risk Assessment Process

3. The group auditor’s understanding of the group’s risk assessment process may include matters such as group management’s risk assessment process, that is, the process for identifying, analyzing, and managing business risks, including the risk of fraud, that may result in material misstatement of the group financial statements. It may also include an understanding of how sophisticated the group’s risk assessment process is and the involvement of entities and business units in this process.

The Group’s Process to Monitor the System of Internal Control

4. The group auditor’s understanding of the group’s process to monitor the system of internal control may include matters such as monitoring of controls, including how the controls are monitored across the group and, when relevant, activities of the internal audit function across the group. The group’s internal audit function, including its nature, responsibilities, and activities in respect of monitoring of controls at entities or business units in the group. AU-C section 610, *Using the Work of Internal Auditors*,² requires the auditor to evaluate the extent to which the internal audit function’s organizational status and relevant policies and procedures support the objectivity of internal auditors, the level of competence of the internal audit function, and whether the internal audit function applies a systematic and disciplined approach, including quality control.

¹ Appendix C of AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

² Paragraph .13 of AU-C section 610, *Using the Work of Internal Auditors*.

The Information System and Communication

5. The group auditor's understanding of the group's information system and communication may include matters such as the following:
- The extent of centralization in the group's IT environment and the commonality of IT applications, IT processes, and IT infrastructure
 - Group management's monitoring of operations and the financial results of entities or business units in the group, including regular reporting routines, which enables group management to monitor performance against budgets and to take appropriate action
 - Monitoring, controlling, reconciling, and eliminating intra-group transactions and unrealized profits, and intra-group account balances at the group level
 - A process for monitoring the timeliness and evaluating the accuracy and completeness of financial information received from entities or business units in the group

Consolidation Process

6. The group auditor's understanding of the consolidation process may include matters such as the following:

Matters relating to the applicable financial reporting framework:

- The extent to which management of entities or business units in the group have an understanding of the applicable financial reporting framework
- The process for identifying and accounting for entities or business units in the group in accordance with the applicable financial reporting framework
- The process for identifying reportable segments for segment reporting in accordance with the applicable financial reporting framework
- The process for identifying related party relationships and related party transactions for reporting in accordance with the applicable financial reporting framework
- The accounting policies applied to the group financial statements, changes from those of the previous financial year, and changes resulting from new or revised standards under the applicable financial reporting framework
- The procedures for dealing with entities or business units in the group with financial year-ends different from the group's year-end

Matters relating to the consolidation process:

- Group management's process for obtaining an understanding of the accounting policies used by entities or business units in the group, and, when applicable, ensuring that uniform accounting policies are used to prepare the financial information of the entities or business units in the group for the group financial statements, and that differences in accounting policies are identified and adjusted when required in terms of the applicable financial reporting framework. Uniform accounting policies are the specific principles, bases, conventions, rules, and practices adopted by the group, based on the applicable financial reporting framework, that the entities or business units in the group use to report similar transactions consistently. These policies are ordinarily described in the financial reporting procedures manual and reporting package issued by group management.

- Group management's process for ensuring complete, accurate, and timely financial reporting by the entities or business units in the group for the consolidation.
- The process for translating the financial information of foreign entities or business units in the group into the currency of the group financial statements.
- How the group's IT environment is organized for the consolidation and the policies that define the flows of information in the consolidation process, including the IT applications involved.
- Group management's process for obtaining information on subsequent events.

Matters relating to consolidation adjustments and reclassifications:

- The process for recording consolidation adjustments, including the preparation, authorization, and processing of related journal entries, and the experience of personnel responsible for the consolidation
- The consolidation adjustments required by the applicable financial reporting framework
- The business rationale for the events and transactions that gave rise to the consolidation adjustments
- Frequency, nature, and size of transactions between entities or business units in the group
- The procedures for monitoring, controlling, reconciling, and eliminating intra-group transactions and unrealized profits, and intra-group account balances
- Steps taken to arrive at the fair value of acquired assets and liabilities, procedures for amortizing goodwill (when applicable), and impairment testing of goodwill, in accordance with the applicable financial reporting framework
- Arrangements with a majority owner or minority interests regarding losses incurred by an entity or business unit in the group (for example, an obligation of the minority interest to make good such losses)

Control Activities

7. The group auditor's understanding of the control activities component may include matters such as the following:
 - The commonality of information processing controls and general IT controls for all or part of the group
 - The extent of the commonality of the design of controls for all or part of the group that address risks of material misstatement of the group financial statements at the assertion level
 - The extent to which commonly designed controls have been implemented consistently for all or part of the group

A223.

Appendix B — Examples of Events or Conditions That May Give Rise to Risks of Material Misstatement of the Group Financial Statements (Ref: par. A123)

The following are examples of events (including transactions) and conditions that may indicate the existence of risks of material misstatement of the group financial statements, whether due to fraud or error, including with respect to the consolidation process. The examples provided by inherent risk factor cover a broad range of events and conditions; however, not all events and conditions are relevant to every group audit engagement and the list of examples is not exhaustive. The events and conditions have been categorized by the inherent risk factor that may have the greatest effect in the circumstances. Importantly, due to the interrelationships among inherent risk factors, the example events and conditions also are likely to be subject to or affected by other inherent risk factors to varying degrees. Also see Appendix B, “Understanding Inherent Risk Factors,” of AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

Inherent Risk Factor	Examples of Events or Conditions That May Give Rise to the Existence of Risks of Material Misstatement of the Group Financial Statements at the Assertion Level:
Complexity	<ul style="list-style-type: none"> • The existence of complex transactions that are accounted for in more than one entity or business unit in the group • The application of accounting policies by entities or business units in the group that differ from those applied to the group financial statements • Accounting measurements or disclosures that involve complex processes used by entities or business units in the group such as accounting for complex financial instruments • Operations that are subject to a high degree of complex regulation in multiple jurisdictions, or entities or business units in the group that operate in multiple industries that are subject to different types of regulation
Subjectivity	<ul style="list-style-type: none"> • Judgments regarding which entities or business units in the group require incorporation of their financial information in the group financial statements in accordance with the applicable financial reporting framework, for example, whether any variable interest entities or non-trading entities exist and require incorporation • Judgments regarding the correct application of the requirements of the applicable financial reporting framework by entities or business units in the group
Change	<ul style="list-style-type: none"> • Frequent acquisitions, disposals, or reorganizations
Uncertainty	<ul style="list-style-type: none"> • Entities or business units in the group operating in foreign jurisdictions that may be exposed to factors such as unexpected government intervention in areas such as trade

	and fiscal policy, restrictions on currency and dividend movements, and fluctuations in exchange rates
Susceptibility to Misstatement Due to Management Bias or Other Fraud Risk Factors Insofar as They Affect Inherent Risk	<ul style="list-style-type: none"> • Unusual related party relationships and transactions • Entities or business units in the group with different financial year-ends, which may be used to manipulate the timing of transactions • Prior occurrences of unauthorized or incomplete consolidation adjustments • Aggressive tax planning within the group or large cash transactions with entities in tax havens • Prior occurrences of intra-group account balances that did not balance or reconcile on consolidation • Large or unusual cash transfers within the group, particularly to newly incorporated entities or business units operating in locations with a significant or heightened fraud risk

Indicators that the control environment, the group's risk assessment process, or the group's process to monitor the group's system of internal control are not appropriate to the group's circumstances, considering the nature and complexity of the group, and do not provide an appropriate foundation for the other components of the group's system of internal control, include the following:

- Poor corporate governance structures, including decision-making processes that are not transparent
- Nonexistent or ineffective controls over the group's financial reporting process, including inadequate group management information on monitoring of operations and financial results of entities or business units in the group

Appendix C — Amendments to Various Statements on Auditing Standards (SASs), as Amended; to SSAE No. 18, *Attestation Standards: Clarification and Recodification*, as Amended, Section 105, *Concepts Common to All Attestation Engagements*; and to Proposed Quality Management Standards

(***Boldface italics*** denotes new language. Deleted text is shown in ~~strike through~~.)

Amendment to SAS No. 117, *Compliance Audits*, as Amended (AICPA, *Professional Standards*, AU-C Section 935) *

1. This amendment to AU-C section 935 would be effective for compliance audits for fiscal periods ending on or after December 15, 2026.

Introduction and Applicability

[No amendment to paragraphs .01–.14.]

Using the Work of Another Auditor

15 When the auditor expects to use the work of another auditor, the auditor should (Ref: par. A12–A13)

- a. confirm whether the other auditor understands and will comply with the relevant ethical requirements, including those related to independence, that apply to the engagement.***
- b. determine that the other auditor has appropriate professional competence and capabilities.***
- c. determine whether to make reference to the compliance audit of the other auditor in the auditor's report.***
- d. when the auditor involves another auditor to perform audit work to fulfill the requirements of this section***
 - i. communicate clearly with the other auditor about the other auditor's respective responsibilities and the auditor's expectations, including the scope and timing of the other auditor's work and the matters expected to be communicated by the other auditor that are relevant to the auditor's conclusions with regard to the compliance audit;***

* An exposure draft, Proposed Statement on Auditing Standards *Amendment to AU-C section 935*, was issued for comment in February 2022. Paragraphs in AU-C section 935 proposed to be amended in this appendix have been renumbered to reflect the amendment proposed in that exposure draft.

- ii. *determine that the other auditor has sufficient time to perform assigned audit procedures; and*
 - iii. *be sufficiently and appropriately involved in the work of the other auditor.*
- e. *evaluate whether the other auditor's work is adequate for the auditor's purposes.*

[No amendment to former paragraphs .15–.48, which are renumbered as paragraphs .16–.49. No amendment to paragraphs .A1–.A11.]

Using the Work of Another Auditor (Ref: par. .15)

A12. Proposed Statement on Auditing Standards (SAS) Quality Management in an Engagement Conducted in Accordance With Generally Accepted Auditing Standards¹⁵ requires the engagement partner to determine that sufficient and appropriate resources to perform the engagement are assigned or made available to the engagement team in a timely manner. Accordingly, the auditor may involve another auditor to perform audit work to fulfill the requirements of this section. The engagement partner may also determine to use work completed by another auditor or to make reference to the compliance audit of another auditor in the auditor's report.

^{fn15} *Paragraph 25 of proposed Statement on Auditing Standards Quality Management in an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.*

A13. Regardless of whether the auditor uses the work of another auditor (including making reference to the compliance audit of another auditor in the auditor's report) as a basis for forming an opinion at the level specified by the governmental audit requirement, the engagement partner remains ultimately responsible, and, therefore, accountable, for compliance with the requirements of this section. Proposed SAS Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors), adapted as necessary in the circumstances, may be useful in fulfilling the requirements in paragraph 15 of this section when using the work of another auditor.

[Subsequent footnotes renumbered. No amendment to paragraphs .A12–.A44, which are renumbered as paragraphs .A14–.A46.]

Appendix — AU-C Sections That Are Not Applicable to Compliance Audits

.A4547 The following AU-C sections and individually enumerated requirement paragraphs of specific AU-C sections are not applicable to a compliance audit performed under this section either because (a) they are not relevant to a compliance audit environment, (b) the procedures and guidance would not contribute to meeting the objectives of a compliance audit, or (c) the subject matter is specifically covered in this section. Where the table in this appendix specifies individual requirement paragraphs rather than an entire AU-C section, the application and other explanatory material paragraphs related to such requirement paragraphs

also do not apply. However, an auditor may apply these AU-C sections and paragraphs if the auditor believes doing so will provide appropriate audit evidence in the specific circumstances to support the auditor’s opinion on compliance.

<i>AU-C Section</i>	<i>Paragraphs Not Applicable to Compliance Audits</i>
...	
600	Paragraphs .26, .39, .41e, .41d, .55, and .56e All
...	

^[fn 1] [Footnote omitted for purposes of this proposed SAS.]

[No further amendment to AU-C section 935.]

Amendments to Various Sections in SAS No. 122, as Amended (AICPA, *Professional Standards*, AU-C secs. 230, 260, 300, 320, 402, 450, 501, 510, 550, 805, 920, and 930)

AU-C Section 230, *Audit Documentation*

2. This amendment to AU-C section 230 would be effective for audits of financial statements for periods ending on or after December 15, 2026.

[No amendment to paragraphs .01–.A29.]

Exhibit — Audit Documentation Requirements in Other AU-C Sections

.A30 The following lists the main paragraphs in other AU-C sections that contain specific documentation requirements. This list is not a substitute for knowledge of the AU-C sections:

...

- q. Paragraphs ~~76-49 and .64~~ of section ~~600~~, ***proposed Statement on Auditing Standards Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)***

...

[No further amendment to AU-C section 230.]

AU-C Section 260, *The Auditor's Communication With Those Charged With Governance*

3. This amendment to AU-C section 260 would be effective for audits of financial statements for periods ending on or after December 15, 2026.

[No amendment to paragraphs .01–.A8.]

Those Charged With Governance

...

.A9 ~~Section 600,~~ *Proposed Statement on Auditing Standards Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*, includes specific matters to be communicated by *the* group auditors with those charged with governance *of the group*.^{fn 3} *The matters communicated may include those brought to the attention of the group auditor by component auditors that the group auditor judges to be significant to the responsibilities of those charged with governance of the group. Component auditors also may communicate matters to those charged with governance of the component.*^{fn 4} When the entity being audited is a component of a group, the appropriate person(s) with whom to communicate is dependent on the nature of the matter to be communicated and the terms of the engagement.

^{fn 3} Paragraphs ~~74 .45–.48~~ of ~~section 600,~~ *proposed Statement on Auditing Standards (SAS) Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*.

^{fn 4} *Paragraph 47i of proposed SAS Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*.

[Subsequent footnotes renumbered. No amendment to paragraphs .A10–.A57.]

Exhibit — Requirements to Communicate With Those Charged With Governance in Other AU-C Sections

.A58 Requirements for the auditor to communicate with those charged with governance are included in other AU-C sections. This section does not change the requirements in

...*i.* paragraphs ~~.45–.48~~ **74** of ~~section 600,~~ *proposed Statement on Auditing Standards Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*

...

[No further amendment to AU-C section 260.]

AU-C Section 300, *Planning an Audit*

4. This amendment to AU-C section 300 would be effective for audits of financial statements for periods ending on or after December 15, 2026.

Scope of This Section

.01 This section addresses the auditor's responsibility to plan an audit of financial statements. This section is written in the context of recurring audits. Additional considerations in an initial audit engagement are separately identified in this section. Matters related to planning audits of group financial statements are addressed in ~~section 600~~, ***proposed Statement on Auditing Standards Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)***. (Ref: par. .A1–.A3)

[No amendment to paragraphs .02–.10.]

...

Planning Activities

...

11. *The engagement partner should review the overall audit strategy and audit plan.*

[No amendment to former paragraphs .11–.14, which are renumbered as paragraphs .12–.15. No amendment to paragraphs .A1–.A8.]

...

Planning Activities

The Overall Audit Strategy (Ref: par. .07–.08)

.A9 The process of establishing the overall audit strategy assists the auditor to determine, subject to the completion of the auditor's risk assessment procedures, such matters as the following:

- The resources to deploy for specific audit areas, such as the use of appropriately experienced team members for high risk areas or the involvement of specialists on complex matters
- The amount of resources to allocate to specific audit areas, such as the number of team members assigned to observe the inventory count at material locations, the ***nature and*** extent of ***direction and supervision of component auditors and the*** review of ***their*** component auditors' work in the case of group audits, or the audit budget (in hours) to allocate to high risk areas

- When these resources are to be deployed, such as whether at an interim audit stage or at key cut-off dates
- How such resources are managed, directed, and supervised, such as when team briefing and debriefing meetings are expected to be held, how the engagement partner and manager reviews are expected to take place (for example, onsite or off-site), and whether to complete engagement quality control reviews
- ***The components for which, if any, the auditor's report on the group financial statements will make reference to the audit of a referred-to auditor***

[No amendment to paragraphs .A10–.A26.]

Appendix — Considerations in Establishing the Overall Audit Strategy (Ref: par. .07–.08 and .A9–.A12)

.A27 This appendix provides examples of matters the auditor may consider in establishing the overall audit strategy. Many of these matters also will influence the auditor's detailed audit plan. The examples provided cover a broad range of matters applicable to many engagements. Although some of the following matters may be required by other AU-C sections, not all matters are relevant to every audit engagement, and the list is not necessarily complete.

...

Characteristics of the Engagement

...

- The expected audit coverage ***scope***, including the ~~number and locations of~~ components ***at which audit work is expected to be performed for purposes of a group audit, the extent to which component auditors will be involved, and the components that are audited by referred-to auditors for which the group auditor plans to make reference to the audit of the referred-to auditor in the auditor's report on the group financial statements*** ~~to be included~~
- The nature of the control relationships between a parent and its ***entities or business units*** ~~components~~ that determine how the group is to be consolidated
- ~~The extent to which components are audited by other auditors~~
- The nature of the ***entities or business units*** ~~divisions~~ to be audited, including the need for specialized ***skills or*** knowledge
- The reporting currency to be used, including any need for currency translation for the audited financial information

- The ~~requirement~~ need for *an audit of financial statements for legal, statutory or regulatory, or other reasons* ~~audit requirements~~ (for example, *Title 2 U.S. Code of Federal Regulations [CFR] Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards [Uniform Guidance]* ~~the Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations~~)

...

Reporting Objectives, Timing of the Audit, and Nature of Communications

...

- Communication with *component* ~~auditors of components~~ regarding the expected types and timing of ~~reports to be issued and other~~ communications in connection with the audit *work performed for purposes of the group audit* ~~of components~~
- *Communication with referred-to auditors regarding the expected types and timing of communications in connection with making reference to the audit of a referred-to auditor in the auditor's report on the group financial statements*
- The expected nature and timing of communications among engagement team members, including the nature and timing of team meetings and timing of the review of *audit* work performed

...

Significant Factors, Preliminary Engagement Activities, and Knowledge Gained on Other Engagements

The following examples illustrate significant factors, preliminary engagement activities, and knowledge gained on other engagements:

- The determination of materiality, in accordance with section 320, *Materiality in Planning and Performing an Audit*, and, when applicable, the following:
 - The determination of *component performance* ~~materiality for components and~~ *the threshold above which misstatements identified in the component financial information are to be communicated to the group auditor and* communication thereof to component auditors in accordance with ~~section 600,~~ *proposed Statement on Auditing Standards Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*
 - The *initial expectations about the* ~~preliminary identification of significant components and material~~ classes of transactions, account balances, and disclosures *that may be significant*

...

[No further amendment to AU-C section 300.]

AU-C Section 320, *Materiality in Planning and Performing an Audit*

5. This amendment to AU-C section 320 would be effective for audits of financial statements for periods ending on or after December 15, 2026.

[No amendment to paragraphs .01–.08.]

Definition

.09 For purposes of generally accepted auditing standards (GAAS), the following term has the meaning attributed as follows:

Aggregation risk. The probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole.

Performance materiality. The amount or amounts set by the auditor at less than materiality for the financial statements as a whole to reduce **aggregation risk** to an appropriately low level ~~the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole.~~ If applicable, *performance materiality* also refers to the amount or amounts set by the auditor at less than the materiality level or levels for particular classes of transactions, account balances, or disclosures. Performance materiality is to be distinguished from tolerable misstatement. (Ref: par. .A3)

...

...

Determining Materiality and Performance Materiality When Planning the Audit

...

Performance Materiality (Ref: par. .11)

.A15 Planning the audit solely to detect individual material misstatements overlooks the fact that the aggregate of individually immaterial misstatements may cause the financial statements to be materially misstated and leaves no margin for possible undetected misstatements. *Performance materiality* (which, as defined, is one or more amounts) is set **at less than materiality for the financial statements as a whole** to reduce **aggregation risk** to an appropriately low level ~~the probability that the aggregate of uncorrected and undetected misstatements in the financial statements exceeds materiality for the financial statements as a whole.~~ Similarly, performance materiality relating to a materiality level determined for a

particular class of transactions, account balance, or disclosure is set to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements in that particular class of transactions, account balance, or disclosure exceeds the materiality level for that particular class of transactions, account balance, or disclosure. The determination of performance materiality is not a simple mechanical calculation and involves the exercise of professional judgment. It is affected by the auditor's understanding of the entity, updated during the performance of the risk assessment procedures, and the nature and extent of misstatements identified in previous audits and, thereby, the auditor's expectations regarding misstatements in the current period.

[No further amendment to AU-C section 320.]

AU-C Section 402, *Audit Considerations Relating to an Entity Using a Service Organization*

6. This amendment to AU-C section 402 would be effective for audits of financial statements for periods ending on or after December 15, 2026.

[No amendment to paragraphs .01–.A18.]

Obtaining an Understanding of the Services Provided by a Service Organization, Including Internal Control

...

Further Procedures When a Sufficient Understanding Cannot Be Obtained From the User Entity (Ref: par. .12)

...

.A19 Another auditor may be used to perform procedures that will provide the necessary information about the controls at the service organization related to services provided to the user entity. If a type 1 or type 2 report has been issued, the user auditor may use the service auditor to perform these procedures as the service auditor has an existing relationship with the service organization. The user auditor using the work of another auditor may find the guidance in ~~section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*~~ ***proposed Statement on Auditing Standards Quality Management for Engagements Conducted in Accordance With Generally Accepted Auditing Standards 600, Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)***, useful as it relates to ***determining the competence and capabilities of the other*** ~~understanding another auditor (including that auditor's independence and professional competence); *the direction and supervision*~~ ***involvement in the work of the other*** ~~another auditor; in planning the nature, timing, and extent, and timing of such~~ ***the work assigned to the other auditor***; and ~~in evaluating the sufficiency and appropriateness of the audit evidence obtained.~~ ^{fn 9}

^{fn 9} See ***Proposed Statement on Auditing Standards Quality Management for Engagements Conducted in Accordance with Generally Accepted Auditing Standards. Paragraphs .02 and .22 of section 600, Special Considerations—Audits of Group Financial Statements (Including the Work of***

~~Component Auditors).~~

[No further amendment to AU-C section 402.]

AU-C Section 450, *Evaluation of Misstatements Identified During the Audit*

7. This amendment to AU-C section 450 would be effective for audits of financial statements for periods ending on or after December 15, 2026.

[No amendment to paragraphs .01–.A24.]

Evaluating the Effect of Uncorrected Misstatements (Ref: par. .10–.11)

...

.A25 The auditor is required by ~~section 600,~~ ***proposed Statement on Auditing Standards Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*** to evaluate the effect on the group audit opinion of any uncorrected misstatement identified by the group **auditor engagement team** or communicated by the component auditors.^{fn 18}

^{fn18} Paragraph ~~69.44~~ of ~~section 600,~~ ***proposed Statement on Auditing Standards Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)***.

[No further amendment to AU-C section 450.]

AU-C Section 501, *Audit Evidence — Specific Considerations for Selected Items*

8. This amendment to AU-C section 501 would be effective for audits of financial statements for periods ending on or after December 15, 2026.

[No amendment to paragraphs .01–.A4.]

Investments in Securities and Derivative Instruments (Ref: par. .05–.06)

...

Investments in Securities When Valuations Are Based on the Investee’s Financial Results (Excluding Investments Accounted for Using the Equity Method of Accounting) (Ref: par. .05–.06)

~~.A5—Section 600~~ ***Proposed Statement on Auditing Standards Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and***

Audits of Referred-to Auditors) addresses auditing investments accounted for using the equity method of accounting.

[No amendment to paragraphs .A6–.A22.]

Inventory

Attendance at Physical Inventory Counting (Ref: par. .12a)

...

.A23 Matters relevant in planning attendance at physical inventory counting (or in designing and performing audit procedures pursuant to paragraphs .12–.16) include, for example, the following:

...

- The locations at which inventory is held, including the materiality of the inventory and the risks of material misstatement at different locations, in deciding at which locations attendance is appropriate. ~~Section 600 addresses the involvement of component auditors and, accordingly, may be relevant if such involvement is with regard to attendance of physical inventory counting at a remote location.~~

...

[No further amendment to AU-C section 501.]

AU-C Section 510, Opening Balances — Initial Audit Engagements, Including Reaudit Engagements

9. This amendment to AU-C section 510 would be effective for audits of financial statements for periods ending on or after December 15, 2026.

[No amendment to paragraphs .01–.A7.]

Audit Procedures (Ref: par. .07)

...

.A8 If the predecessor auditor permits access to the audit documentation, the auditor may review the predecessor auditor’s audit documentation for information relevant to planning and performing the audit. The auditor’s determination whether to use information resulting from such review as part of the auditor’s risk assessment procedures or as evidence regarding the opening balances is influenced by the auditor’s assessment of the professional

competence and independence of the predecessor auditor. Although the predecessor auditor is not a component auditor *or referred-to auditor*, as defined in ~~section 600~~, **proposed Statement on Auditing Standards Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)**, the auditor may **perform procedures** ~~make inquiries~~ similar to those **included** ~~listed~~ in section 600 concerning the professional competence **and capabilities** and independence of the predecessor auditor. ^{fn1} (Ref: par. .07 and .08c)

^{fn1} Paragraphs ~~2227, 28, 51, and 52~~ of ~~section 600~~, **proposed Statement on Auditing Standards Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)**.

[No further amendment to AU-C section 510.]

AU-C Section 550, Related Parties

10. This amendment to AU-C section 550 would be effective for audits of financial statements for periods ending on or after December 15, 2026.

[No amendment to paragraphs .01–.A10.]

Risk Assessment Procedures and Related Activities

Understanding the Entity’s Related Party Relationships and Transactions

The Identity of the Entity’s Related Parties (Ref: par. .14a)

...

.A11 In the context of a group audit, ~~section 600~~ **proposed Statement on Auditing Standards Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)** requires the group **auditor engagement team** to **request component auditors and referred-to auditors to communicate related party relationships not previously identified by group management or the group auditor on a timely basis** ~~provide each component auditor with information about related parties prepared by group management and any other related parties of which the group engagement team is aware, including the nature of the entity's relationships and transactions with those related parties.~~ ^{fn 24} ~~When the entity is a component within a group, this~~ **Such** information provides a useful basis for the **group** auditor’s inquiries of management regarding the identity of ~~the entity’s~~ related parties.

^{fn 24} Paragraph ~~34b-40e and 62d(ii)~~ of ~~section 600~~ **proposed Statement on Auditing Standards Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)**.

[No amendment to paragraphs .A12–.A30.]

Sharing Related Party Information With the Engagement Team (Ref: par. .19 and .25a)

...

.A31 ~~Section 600~~ *Proposed Statement on Auditing Standards Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)* addresses the communications that apply to group audits, particularly those that involve component auditors *or when reference is made to referred-to auditors*.

[No amendment to paragraphs .A32–.A41.]

Responses to the Risks of Material Misstatement Associated With Related Party Relationships and Transactions (Ref: par. .22)

...

Identified Related Party Transactions Required to Be Disclosed or Determined to Be a Significant Risk

Evaluating the Business Purpose (Ref: par. .26a(i))

.A42 In evaluating the business purpose of a related party transaction that is required to be disclosed in the financial statements or determined to be a significant risk, the auditor may consider the following:

- Whether the transaction
 - is overly complex (for example, it may involve multiple related parties within a ~~consolidated~~ group)

...

[No further amendment to AU-C section 550.]

AU-C Section 805, *Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*

11. This amendment to AU-C section 805 would be effective for audits of single financial statements or specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2026.

Scope of This Section

[No amendment to paragraph .01.]

.02 This section does not apply to *circumstances in which the report-audit procedures are performed by* ~~of a component auditor issued as a result of work performed on the financial~~

information of a component at the request of a group engagement team for purposes of an audit of group financial statements (see section 600, *proposed Statement on Auditing Standards Special Considerations — Audits of Group Financial Statements [Including the Work of Component Auditors and Audits of Referred-to Auditors]*).

[No further amendment to AU-C section 805.]

AU-C Section 920, Letters for Underwriters and Certain Other Requesting Parties

12. This amendment to AU-C section 920 would be effective for comfort letters issued on or after December 15, 2026.

[No amendment to paragraphs .01–.20.]

...

Agreeing Upon the Scope of Services

...

.21 Situations may exist in which one or more component auditor’s *or referred-to auditor’s* report is included in the securities offering. When comfort letters are issued to requesting parties by those component auditors *or referred-to auditors*, the auditor of the group financial statements should read those comfort letters. The auditor of the group financial statements should state in the comfort letter that the procedures relating to those components consisted solely of reading the component auditors’ *or referred-to auditors’* comfort letters.

[No amendment to paragraphs .22–.A18.]

...

Agreeing Upon the Scope of Services (Ref: par. .15–.23)

...

.A19 Comfort letters are requested occasionally from more than one auditor, for example, in connection with securities offerings to be used in the subsequent sale of shares issued in recently effected mergers and from predecessor auditors. In such circumstances, it is the entity’s responsibility, at the earliest practicable date, to inform any other auditors who may be involved about any letter that may be requested of them and arrange for them to receive a draft of the underwriting agreement so that they may make arrangements at an early date for the preparation of a draft of their letter and for the performance of their procedures. The entity or requesting party is also responsible for arranging for a copy of the comfort letters of component auditors *or referred-to auditors* in draft and final form to be provided to the auditor of the group financial statements.

[No amendment to paragraphs .A20–.A26.]

...

Format and Contents of Comfort Letters

...

Addressee (Ref: par. .26)

.A27 An example of an appropriate form of address for this purpose is "The Blank Company and XYZ & Company, as Representative of the Several Underwriters." Copies of a comfort letter addressed in accordance with the requirements in paragraph .26 may be provided to the auditor of the group financial statements when a comfort letter related to a component included in group financial statements is issued by a component auditor *or referred-to auditor*.

[No amendment to paragraphs .A28–.A69.]

...

Commenting in a Comfort Letter on Information Other Than Audited Financial Statements

...

Subsequent Changes (Ref: par. .58–.64)

...

.A70 When more than one auditor is involved, the auditor of the group financial statements may comment that there were no decreases in the consolidated financial statement items, when appropriate, despite the possibility that decreases have been mentioned in a comfort letter issued by a component auditor *or referred-to auditor*. Exhibit B, example J, "Alternate Wording When Component Auditors Are Involved *or When Making Reference to the Audit of a Referred-to Auditor*," contains an illustration of wording when more than one auditor is involved.

[No amendment to paragraphs .A71–.A92.]

Exhibit B — Examples of Comfort Letters

.A93

...

Example J — Alternate Wording When Component Auditors Are Involved *or When Making Reference to the Audit of a Referred-to Auditor* [.A93-14](#)

...

Example J — Alternate Wording When Component Auditors Are Involved *or When Making Reference to the Audit of a Referred-to Auditor*

.A93-14 Example J applies when one or more component auditors are involved in the audit of group financial statements *or when reference is made to the audit of a referred-to auditor in the auditor’s report on group financial statements*, and the group engagement team has obtained a copy of the comfort letter of the component auditors *or referred-to auditors* (see paragraph .21). Example J consists of an addition to paragraph 4, a substitution for the applicable part of paragraph 5, and an addition to paragraph 6 of example A-1 and corresponding changes to paragraphs 3, 4, and 5 of example A-2, respectively.

[No further amendment to AU-C section 920.]

AU-C Section 930, *Interim Financial Information*

13. This amendment to AU-C section 930 would be effective for reviews of interim financial information for interim periods of fiscal years ending on or after December 15, 2026.

[No amendment to paragraphs .01–.13.]

Procedures for a Review of Interim Financial Information

...

Analytical Procedures, Inquiries, and Other Review Procedures

...

Inquiries and Other Review Procedures

.14 The auditor should make the following inquiries and perform the following other review procedures when conducting a review of interim financial information:

- a. Read the available minutes of meetings of stockholders, directors, and appropriate committees and inquire about matters dealt with at meetings for which minutes are not available to identify matters that may affect the interim financial information. (Ref: par. .A16)

- ~~b. Obtain reports from component auditors, if any, related to reviews performed of the interim financial information of significant components of the reporting entity, including its investees, or inquire of those auditors if reports have not been issued. (Ref: par. .A17)~~

...

[No amendment to paragraphs .15–.A16.]

Procedures for a Review of Interim Financial Information

...

Analytical Procedures, Inquiries, and Other Review Procedures

...

Inquiries and Other Review Procedures (Ref: par. .14)

...

~~.A17~~ The auditor may find the guidance in section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)* useful in conducting a review of interim financial information for an entity that prepares group financial statements.

[No amendment to paragraphs .A18–.A54.]

Relevant Ethical Requirements (Ref: par. .31d(v))

...

.A55 Relevant ethical requirements may exist in several different sources, such as ethical codes and additional rules and requirements within law and regulation. When independence and other relevant ethical requirements are contained in a limited number of sources, the auditor may choose to name the relevant sources (for example, the AICPA code, when applicable; the rule or applicable regulation; or *Government Auditing Standards* promulgated by the Comptroller General of the United States) or may refer to a term that appropriately describes those sources. Relevant ethical requirements, including those pertaining to independence, in a group audit situation may be complex. ~~Section 600, *Proposed SAS Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*~~^{fn11} provides guidance for auditors in performing work on the financial information of a component for a group audit, including those situations in which the component auditor *or referred-to auditor* does not meet the independence requirements that are relevant to the group audit.

^{fn 11} Paragraphs ~~22–23~~ 27, 29, 47c, 51, 53, and 63a of section 600, *proposed Statement on Auditing Standards Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*.

[No amendment to paragraphs .A56–.A78.]

Exhibit B — Illustrations of Auditor’s Review Reports on Interim Financial Information (Ref: par. .A44)

.A79

...

Illustration 3 — A Review Report That Refers to a ~~Referred-to Component~~ Auditor's Review Report on the Interim Financial Information of a ~~Significant~~ Component of a Reporting Entity

...

...

Illustration 3 — A Review Report That Refers to a ~~Referred-to Component~~ Auditor's Review Report on the Interim Financial Information of a ~~Significant~~ Component of a Reporting Entity

Circumstances include the following:

- A review of interim financial information presented as a complete set of financial statements, including disclosures.
- The auditor is making reference to ~~a referred-to another~~ auditor's review report on the interim financial information of a ~~significant~~ component of a reporting entity.

...

[No further amendment to AU-C section 930.]

Amendment to SAS No. 128, *Using the Work of Internal Auditors, As Amended* (AICPA, *Professional Standards*, AU-C sec. 610)

14. This amendment to AU-C section 610 would be effective for audits of financial statements for periods ending on or after December 15, 2026.

AU-C Section 610, *Using the Work of Internal Auditors*

[No amendment to paragraphs .01–.A19.]

Determining Whether, in Which Areas, and to What Extent the Work of the Internal Audit Function Can Be Used in Obtaining Audit Evidence

...

Determining the Nature and Extent of Work of the Internal Audit Function That Can Be Used in Obtaining Audit Evidence

Factors Affecting the Determination of the Nature and Extent of the Work of the Internal Audit Function That Can Be Used (Ref: par. .15–.18)

...

.A20 In accordance with section 330, the external auditor is required to design and perform further audit procedures whose nature, timing, and extent are based on, and responsive to, the assessed risks of material misstatement at the relevant assertion level.^{fn 9} Further audit procedures comprise tests of controls and substantive procedures. Procedures planned or performed by the internal audit function may be the same as, or be similar to, the further audit procedures that the external auditor would design and perform. Accordingly, subject to the requirements of this section, the external auditor may determine that it is appropriate to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of further audit procedures to be performed directly by the external auditor. The internal audit function may have performed, or may be planning to perform

- tests of relevant controls upon which the external auditor intends to rely in determining the nature, timing, and extent of substantive procedures. For example, the work of the internal audit function may include tests of relevant controls that address the risks of material misstatement related to the completeness of accounts payable. The results of the internal audit function's tests may provide evidence about the effectiveness of controls and, accordingly, the external auditor may be able to use such tests of controls performed by the internal audit function to modify the nature or timing, or reduce the extent of, testing of controls the external auditor would otherwise have performed directly.
- substantive procedures. For example, the internal audit function, as part of its work, may confirm certain accounts receivable and observe certain physical inventories. By using such work of the internal audit function in obtaining audit evidence, the external auditor may be able to change the timing of the confirmation procedures, the number of accounts receivable to be confirmed, or the number of locations of physical inventories to be observed.

The internal audit function's plan may also include procedures related to financial information of components of a group. The external auditor may coordinate work with the internal auditors (in accordance with paragraph .20 of this section) ***in determining the components at which audit work will be performed*** and ~~reduce the number of the entity's components at which the external auditor would otherwise need to perform audit procedures~~ in accordance with the requirements of ***proposed Statement on Auditing Standards section 600, Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)***.

^{fn 9} [Footnote omitted for purposes of this proposed SAS.]

[No further amendment to AU-C section 610.]

Amendment to SAS No. 130, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*, as Amended (AICPA, Professional Standards, AU-C sec. 940)

15. This amendment to AU-C section 940 would be effective for integrated audits for periods ending on or after December 15, 2026.

AU-C section 940, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*

[No amendment to paragraphs .01–.66.]

Report Modifications

.67 The auditor should modify the report on ICFR if any of the following conditions exist:

- a. One or more material weaknesses exist.
- b. Elements of management’s report are incomplete or improperly presented.
- c. There is a limitation on the scope of the engagement. (Ref: par. .A119)
- d. The auditor decides to refer to the report of a *referred-to component* auditor as the basis, in part, for the auditor’s own opinion.
- e. There is other information contained in management's report.

[No amendment to paragraphs .68–.77.]

...

Making Reference to a Referred-to Component Auditor and Involving Assuming Responsibility for the Work of a Component Auditors in the Group Audit

.78 *In a group audit*—When an entity includes one or more components, the group engagement partner should *determine* evaluate whether the group engagement team will be able to obtain sufficient appropriate audit evidence *can reasonably be expected to be obtained (including through involving component auditors or through making reference to the audit of a referred-to auditor in the auditor’s report on the group financial statements)* through the group engagement team’s work or use of the work of component auditors (that is, through assuming responsibility for the work of component auditors or making reference to the audit of ICFR of a component auditor in the auditor’s report) to *provide a basis for forming an opinion on* act as the auditor of the ICFR over the group financial statements and report as such on the ICFR over the group financial statements, as required by section 600, *proposed Statement on Auditing Standards Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*.^{fn 9} (Ref: par. .A128)

^{fn 9} Paragraph ~~19.15~~ of *proposed Statement on Auditing Standards (SAS)* ~~section 600~~, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*.

.79 As required by ~~section 600~~, *proposed SAS Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*, the group engagement partner should determine whether to make reference to *the audit of a referred-to component auditor* in the *auditor's* report on the ICFR over the group financial statements.^{fn 10} Reference to the audit of a *referred-to component auditor* in the auditor's report on the ICFR over the group financial statements should not be made unless

- a. the engagement partner has determined that the *referred-to component auditor* has performed an audit of the component's ICFR in accordance with the relevant requirements of GAAS (or, if applicable, the standards promulgated by the PCAOB) and
- b. the *referred-to component auditor* has issued an auditor's report on ICFR that is not restricted as to use. (Ref: par. .A128–.A129)^{fn 11}

^{fn 10} Paragraph ~~24.55~~ of ~~section 600~~, *proposed SAS Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*.

^{fn 11} *Paragraph 56 of proposed SAS Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*.

[Subsequent footnotes renumbered. No amendment to paragraph .80.]

Special Topics

Entities With Multiple Components

.81 In determining the components at which to perform tests of controls, the group *auditor engagement team* should **take responsibility for the identification and assessment of** the risk of material misstatement to the *group* financial statements associated with the component and correlate the amount of attention devoted to the component with the degree of risk. (Ref: par. .A133–.A135)

.82 In assessing and responding to risk, the group *auditor engagement team* should **take responsibility for testing**, or have a component auditor test on the group engagement team's behalf, controls over specific risks that present a reasonable possibility of material misstatement to the group financial statements. (Ref: par. .A136)

.83 In applying the requirement in paragraph .42 regarding special considerations for subsequent years' audits, the group *auditor engagement team* should vary the nature, timing, and extent of tests of controls at components from year to year.

[No amendment to paragraphs .84–.A127.]

Report Modifications

...

Making Reference to a Referred-to ~~Component~~ Auditor and Involving ~~Assuming~~ Responsibility for the Work of a Component Auditors in the Group Audit (Ref: par. .78–.79)

.A128 ~~Section 600, Proposed SAS Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)~~ addresses special considerations that apply to group audits, in particular those that involve component auditors *or when reference is made to referred-to auditors*. ~~Section 600 Proposed SAS Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)~~ is applicable, adapted as necessary, to the audit of ICFR, considering the requirements and guidance related to multiple components discussed beginning in paragraphs .28 and .81.

.A129 The group engagement partner may *determine* ~~decide to~~ *involve* ~~assume responsibility for the work of the component auditors or to make reference to the *audit of a referred-to component* auditor in the report on the ICFR over the group financial statements.~~ The decision about whether to make reference to *the audit of a referred-to component* auditor in the report on the audit of ICFR might differ from the corresponding decision as it relates to the audit of the financial statements. For example, the audit report on the group financial statements may make reference to the audit of a significant equity investment performed by a *referred-to component* auditor, but the report on the ICFR over the group financial statements might not make a similar reference because management’s assessment about ICFR ordinarily would not extend to controls at the equity method investee. See paragraph .84 for further discussion of the evaluation of the controls for an equity method investment.

.A130 ~~Section 600 Proposed SAS Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)~~ establishes requirements and provides guidance when *involving* ~~assuming responsibility for the work of a component auditors~~ *in a group audit* and when making reference to *the audit of a referred-to component* auditor in the auditor’s report on the *group* financial statements that are adapted and applied, as necessary, to the audit of ICFR. Exhibit A of this section includes an illustration of the application of the reporting requirements in ~~section 600, proposed SAS Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)~~.^{fn 32}

^{fn 32} Illustration 4, "Unmodified Opinion on ICFR Making Reference to *the Audit of a Referred-to Component Auditor*," of exhibit A.

[No amendment to paragraphs .A131–.A132.]

Special Topics

Entities With Multiple Components (Ref: par. .81–.83)

~~.A133~~ As indicated in paragraph .A128 of this section, ~~section 600~~ **proposed SAS Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)** is applicable, adapted as necessary, to the audit of ICFR, considering the requirements and guidance related to components discussed in this section.

~~.A134~~ In determining the components at which ~~to perform~~ tests of controls **will be performed**, the group **auditor** engagement team may also take into account work performed by the internal audit function or others on behalf of management. For example, if the internal audit function’s planned procedures include relevant audit work at various components, the **group** auditor may **decide to use that work in accordance with AU-C section 610, Using the Work of Internal Auditors** ~~coordinate work with the internal auditors and reduce the number of components at which the group engagement team, or a component auditor on the group engagement team’s behalf, would otherwise need to perform audit procedures.~~

A135. In the context of a group audit, the phrase “the group auditor should take responsibility for...” is used for those requirements when the group auditor is permitted to assign the design or performance of procedures, tasks, or actions to other appropriately skilled or suitably experienced members of the engagement team, including component auditors.

~~.A135~~ The group engagement team may eliminate from further consideration components that, individually or when aggregated with others, do not present a reasonable possibility of material misstatement to the group financial statements.

~~.A136~~ In lower risk components ~~T~~the group-**auditor** engagement team ~~first might~~ **may** evaluate whether testing entity-level controls, including controls in place to provide assurance that appropriate controls exist throughout the organization, provides sufficient appropriate audit evidence **for one or more relevant assertions for a significant class of transactions, account balance, or disclosure**. ~~The group engagement team or a component auditor on the group engagement team’s behalf may test the operating effectiveness of controls over specific risks or group-wide controls.~~

[No amendment to paragraphs .A137–.A155.]

Exhibit A — Illustrative Reports

.A156 The following illustrate the report elements described in this section. The illustrations assume that the audit of internal control over financial reporting (ICFR) and the audit of the financial statements were performed by the same auditor. Report modifications are discussed beginning in paragraph .67 of this section.

Illustration 1 — Unmodified Opinion on ICFR

Illustration 2 — Adverse Opinion on ICFR

Illustration 3 — Disclaimer of Opinion on ICFR

Illustration 4 — Unmodified Opinion on ICFR Making Reference to *the Audit of a Referred-to a Component Auditor*

Illustration 5 — Combined Report Expressing an Unmodified Opinion on ICFR and an Unmodified Opinion on the Financial Statements

...

Illustration 4 — Unmodified Opinion on ICFR Making Reference to *the Audit of a Referred-to a Component Auditor*

The following is an illustrative report expressing an unmodified opinion on ICFR when the engagement partner decides to make reference to the *audit report* of a *referred-to component* auditor.

...

[No further amendment to AU-C section 940.]

Amendment to Various Sections in SAS No. 134, *Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements*, as Amended, Section 700, *Forming an Opinion and Reporting on Financial Statements*, Section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, and Section 705, *Modification to the Opinion in the Independent Auditor's Report* (AICPA, *Professional Standards*, AU-C secs. 700, 701, and 705)

AU-C Section 700, *Forming an Opinion and Reporting on Financial Statements*

16. This amendment to AU-C section 700 would be effective for audits of financial statements for periods ending on or after December 15, 2026.

[No amendment to paragraphs .01–.A38.]

Auditor's Report (Ref: par. .21)

...

Auditor's Report for Audits Conducted in Accordance With GAAS

...

Basis for Opinion (Ref: par. .28)

...

.A39 Relevant ethical requirements may exist in several different sources, such as ethical codes and additional rules and requirements within law and regulation. When independence and other relevant ethical requirements are contained in a limited number of sources, the auditor may choose to name the relevant sources (for example, the AICPA Code of Professional Conduct, when applicable; the rule or applicable regulation; or *Government Auditing Standards* promulgated by the Comptroller General of the United States) or may refer to a term that appropriately describes those sources. Relevant ethical requirements, including those pertaining to independence, in a group audit situation may be complex. ~~Section 600, *Proposed Statement on Auditing Standards Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*~~^{fn 21} provides guidance for auditors in performing work on the financial information of a component for a group audit, including those situations in which the component auditor *or referred-to auditor* does not meet the independence requirements that are relevant to the group audit.

^{fn 21} Paragraphs ~~22–23~~ 27, 29, 47c, 51, 53, and 63a of ~~section 600, *proposed Statement on Auditing Standards Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*~~.

[No amendment to paragraphs .A40–.A80.]

Exhibit — Illustrations of Auditor's Reports on Financial Statements (Ref: par. .A24, .A32, .A65, and .A71)

.A81

...

Illustration 4 — An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Audit Has Been Conducted in Accordance With Both Auditing Standards Generally Accepted in the United States of America and International Standards on Auditing

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative). The audit is a group audit. The auditor is not making reference to *the audit of a referred-to component* auditor in the auditor's report.

...

[No further amendment to AU-C section 700.]

AU-C Section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

17. This amendment to AU-C section 701 would be effective for audits of financial statements for periods ending on or after December 15, 2026.

[No amendment to paragraphs .01–.A12.]

Determining Key Audit Matters (Ref: par. .08–.09)

...

Matters That Required Significant Auditor Attention (Ref: par. .08)

...

.A13 Certain AU-C sections, such as the following, require specific communications with those charged with governance and others that may relate to areas of significant auditor attention:

- a. Section 260, *The Auditor's Communication With Those Charged With Governance*, requires the auditor to communicate significant difficulties, if any, encountered during the audit with those charged with governance.^{fn 7} For example, there may be potential difficulties relating to the following:
 - i. Related party transactions. In particular, there may be limitations on the auditor's ability to obtain audit evidence that all other aspects of a related party transaction (other than price) are equivalent to those of a similar arm's length transaction.^{fn 8}
 - ii. Limitations on the group audit. For example, the group engagement team's access to information **or people** may be restricted.^{fn 9}

^{fns 7-8} [Footnotes omitted for purposes of this proposed SAS.]

^{fn 9} Paragraph ~~49d~~ **74c** of ***proposed Statement on Auditing Standards*** ~~section 600~~, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*.

[No further amendment to AU-C section 701.]

AU-C Section 705, *Modification to the Opinion in the Independent Auditor's Report*

18. This amendment to AU-C section 705 would be effective for audits of financial statements for periods ending on or after December 15, 2026.

[No amendment to paragraphs .01–.A10.]

.A11 Examples of circumstances beyond the control of the entity include the following:

- The entity’s accounting records have been destroyed.
- The accounting records of a significant component ***for which further audit procedures are determined to be necessary for purposes of the group audit*** have been seized indefinitely by governmental authorities.

[No amendment to paragraphs .A12–.A37.]

Exhibit — Illustrations of Auditor’s Reports With Modifications to the Opinion

.A38

...

Illustration 3 — An Auditor’s Report Containing an Adverse Opinion Due to a Material Misstatement of the Financial Statements

Circumstances include the following:

- Audit of a complete set of consolidated general purpose financial statements (single year). The audit is a group audit. The auditor is not making reference to ***the audit of a referred-to component*** auditor in the auditor’s report.

...

[No further amendment to AU-C section 705.]

Amendment to SAS No. 137, *The Auditor’s Responsibilities Relating to Other Information Included in Annual Reports*, as Amended (AICPA, Professional Standards, AU-C sec. 720)

19. This amendment to AU-C section 720 would be effective for audits of financial statements for periods ending on or after December 15, 2026.

AU-C section 720, *The Auditor’s Responsibilities Relating to Other Information Included in Annual Reports*

[No amendment to paragraphs .01–.A1.]

.A2 Other AU-C sections provide requirements and guidance with respect to information in certain documents other than annual reports, for example, section 925, *Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933*; section 945, *Auditor*

Involvement With Exempt Offering Documents; and ~~Statement on Auditing Standards No. 136~~ **section 703**, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA* (see 703).^{fn 3}

^{fn 3} [Footnote deleted, March 2022, to reflect conforming changes necessary due to the issuance of SAS No. 136.]

[No amendment to paragraphs .A3–.A35.]

...

Reading and Considering the Other Information (Ref: par. .16–.17)

...

.A36 In the case of a group audit, though the group auditor is required to read the entirety of the other information if, in accordance with ~~section 600~~, ***proposed Statement on Auditing Standards Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)***,^{fn10} the group auditor decides to make reference to ***the audit of a referred-to component*** auditor in the auditor’s report on the group financial statements, the group auditor’s knowledge does not extend beyond that obtained by the group auditor during the audit of the group financial statements.

^{fn 10} Paragraph ~~.24.55~~ of ~~section 600~~, ***proposed Statement on Auditing Standards Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)***.

[No amendment to paragraphs .A37–.A38.]

.A39 The manner in which an auditor resolves a concern regarding whether other information is materially inconsistent with the auditor’s knowledge obtained in the audit is a matter of professional judgment. The auditor may determine that referring to relevant audit documentation or making inquiries of relevant members of the engagement team, ***including*** ~~or~~ relevant component auditors, is appropriate as a basis for the auditor’s consideration of whether a material misstatement exists. Whether, and if so, the extent to which, the auditor refers to relevant audit documentation or makes inquiries of relevant members of the engagement team, ***including*** ~~or~~ relevant component auditors, is a matter of professional judgment.

.A40 It may not be necessary for the auditor to refer to relevant audit documentation or to make inquiries of relevant members of the engagement team, ***including*** ~~or~~ relevant component auditors, about any matter included in the other information. This may be the case, for example, when the group auditor decides to make reference to ***the audit of a referred-to component*** auditor in the auditor’s report in accordance with ~~section 600~~ ***proposed SAS Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)***,^{fn11} and the group auditor has obtained sufficient knowledge in connection with the group audit

about matters in the other information relating to the ~~significant~~ component with respect to which the *referred-to* component auditor has performed an audit of the financial statements.

^{fn 11} Paragraph 55 of ~~section 600~~ *proposed SAS Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*.

[No further amendment to AU-C section 720.]

Amendment to SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (AICPA, Professional Standards, AU-C sec. 315)

20. This amendment to SAS No. 145 would be effective for audits of financial statements for periods ending on or after December 15, 2026.

AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*

[No amendment to paragraphs .01–.A16.]

Risk Assessment Procedures and Related Activities (Ref: par. .13–.18)

.A17 The risks of material misstatement to be identified and assessed include both those due to fraud and those due to error, and both are covered by this SAS. However, the significance of fraud is such that further requirements and guidance are included in AU-C section 240 in relation to risk assessment procedures and related activities to obtain information that is used to identify and assess the risks of material misstatement due to fraud.^{fn19} In addition, the following AU-C sections provide further requirements and guidance on identifying and assessing risks of material misstatement regarding specific matters or circumstances:

- AU-C section 540, *Auditing Accounting Estimates and Related Disclosures*, with regard to accounting estimates
- AU-C section 550, *Related Parties*, with regard to related party relationships and transaction
- AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, with regard to going concern
- ~~AU-C section 600, *Proposed Statement on Auditing Standards (SAS) Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*~~, with regard to group financial statements

^{fn 19} [Footnote omitted for purposes of this proposed SAS.]

[No amendment to paragraphs .A18–.A52.]

Engagement Team Discussion (Ref: par. .17–.18)

Scalability

...

.A53 When an engagement is carried out by a large engagement team, such as for an audit of group financial statements, it is not always necessary or practical for the discussion to include all members in a single discussion (for example, in a multi-location audit), nor is it necessary for all the members of the engagement team to be informed of all the decisions reached in the discussion. The engagement partner may discuss matters with key members of the engagement team, including, if considered appropriate, those with specific skills or knowledge and those ~~responsible for the performing work at audits of~~ components, while delegating discussion with others, taking into account the extent of communication considered necessary throughout the engagement team. A communications plan, agreed to by the engagement partner, may be useful.

[No amendment to paragraphs .A54–.A246.]

Identifying and Assessing the Risks of Material Misstatement (*Ref: par. .32–.41*)

...

Assessing Risks of Material Misstatement at the Assertion Level

...

Significant Risks (Ref: par. .36)

Why Significant Risks Are Determined and the Implications for the Audit

.A247 The determination of significant risks allows for the auditor to focus more attention on those risks that are close to the upper end of the spectrum of inherent risk, through the performance of certain required responses, including the following:

...

- ~~Section 600~~ **Proposed SAS Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)** requires *the group auditor to evaluate the appropriateness of the design and performance of further audit procedures for areas of higher assessed risks of material misstatement of the group financial statements, or significant risks, on which a component auditor is determining the further audit procedures to be performed* ~~more involvement by the group engagement partner if the significant risk relates to a component in a group audit and for the group engagement team to direct the work required at the component by the component auditor.~~ ^{fn 65}

^{fn 65} Paragraphs ~~.57–.58~~ **44** of AU-C section ~~600~~, **proposed SAS Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)**.

[No further amendment to AU-C section 315.]

**Amendment to Statement on Standards for Attestation Engagements (SSAE) No. 18
*Attestation Standards: Clarification and Recodification, as Amended, Section 105, Concepts Common to All Attestation Engagements (AICPA, Professional Standards, AT-C sec. 105)***

20. This amendment to AT-C section 105, *Concepts Common to All Attestation Engagements*, would be effective for attestation reports dated on or after December 15, 2026.

[No amendment to paragraphs .01–.32.]

.33 When the practitioner expects to use the work of ~~an other~~ **another** practitioner, the practitioner should (Ref: par. .A59–.A60)

- ~~a. obtain an understanding of whether~~ **confirm that** the other practitioner understands and will comply with the **relevant** ethical requirements, **including those related to independence**, that ~~are relevant~~ **apply** to the engagement and, in particular, is independent.
- ~~b. obtain an understanding of~~ **determine that** the other practitioner's **has appropriate** professional competence **and capabilities**.
- c. determine whether to make reference to the other practitioner in the practitioner's report.**
- d. when the practitioner involves another practitioner to perform work to provide evidence for the engagement**
 - ie.** communicate clearly with the other practitioner about **their respective responsibilities and the practitioner's expectations, including** the scope and timing of the other practitioner's work and findings,
 - ii. determine that the other auditor has sufficient time to perform assigned audit procedures, and**
 - ~~iii. if assuming responsibility for the work of the other practitioner,~~ **sufficiently and appropriately** involved in the work of the other practitioner.
- e. evaluate whether the other practitioner's work is adequate for the practitioner's purposes.

[No further amendment to AT-C section 105].

Proposed Statements on Quality Management Standards *Quality Management*

Proposed Statement on Quality Management Standards (SQMS) No. 1, *A Firm's System of Quality Management*[†]

21. This amendment to proposed SQMS No. 1 would be effective for systems of quality management designed and implemented by December 15, 2025, and for evaluations of the system of quality management performed by December 15, 2025.

[No amendment to paragraphs 1– A67.]

A68. ~~AU-C section 600~~⁶ *Proposed Statement on Auditing Standards Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)* states that when component auditors are not subject to the AICPA code, compliance with the ethics and independence requirements set forth in the International Federation of Accountants Code of Ethics for Professional Accountants is sufficient to fulfill the component auditor's ethical responsibilities in the group audit.⁷ Procedures the firm may use regarding the fulfillment of relevant ethical requirements that apply to them by network firms, employees of network firms, or service providers may include confirmations, letters of representation, or other affirmations.

⁶ Paragraph ~~A46-A68~~ of ~~AU-C section 600~~, *proposed Statement on Auditing Standards Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*.

⁷ The section, "Application of the AICPA Code" (ET sec. 0.200.020), of the AICPA Code of Professional Conduct (AICPA code) explains that an AICPA member who is the group engagement partner of a U.S. consolidated entity should be considered to have performed an audit in accordance with generally accepted auditing standards, and in compliance with the AICPA code, provided that component auditors that are not subject to the AICPA code are in compliance with the ethics and independence requirements set forth in the International Federation of Accountants Code of Ethics.

[No amendment to paragraphs A69–A119.]

Information and Communication (Ref: par. 34)

...

Communication Within the Firm (Ref: par. 34b–c)

[†] Proposed Statement on Quality Management Standards (SQMS) No. 1, *A Firm's System of Quality Management*, has not been finalized. It is expected that the final SQMS will be issued in 2022. The content of the paragraphs in proposed SQMS No. 1 that are shown in this appendix may change between the time of issuance of this exposure draft and the issuance of the final SQMS.

A120. The firm may recognize and reinforce the responsibility of personnel and engagement teams to exchange information with the firm and one another by establishing communication channels to facilitate communication across the firm. Examples of communication among the firm, engagement teams, and other individuals include the following:

- ~~The g~~Group ~~auditor engagement teams~~ communicates matters to component auditors in accordance with the firm’s policies or procedures, including matters related to quality management at the engagement level.

...

[No further amendment to proposed SQMS No. 1.]

Proposed SQMS No. 2, *Engagement Quality Reviews* (proposed SQMS No. 2) ‡

22. This amendment to proposed SQMS No. 2 would be effective for audits or reviews of financial statements for periods ending on or after December 15, 2026, and other engagements in the firm’s accounting and auditing practice beginning on or after December 15, 2025. An engagement in the firm’s accounting and auditing practice begins when an engagement letter or other agreement to perform attest services is signed, or when the firm begins to perform the engagement, whichever is earlier.⁸

[No amendment to paragraphs 1–A30.]

Performance of the Engagement Quality Review (Ref: par. 24–27)

...

Procedures Performed by the Engagement Quality Reviewer (Ref: par. 25–27)

...

Group Audit Considerations

A31. The performance of an engagement quality review for an audit of group financial statements may involve additional considerations for the individual appointed as the engagement quality reviewer for the group audit, depending on the size and complexity of the group. Paragraph 21a requires the firm’s policies or procedures to require the engagement quality reviewer to take overall responsibility for the performance of the engagement quality review. In doing so, for larger and more complex group audits, the group engagement quality reviewer may need to discuss significant matters and significant judgments with key members of the engagement team other than the group ~~auditor engagement team~~ (for example, ~~those responsible for performing audit procedures on the financial information of a~~

‡ Proposed SQMS No. 2, *Engagement Quality Reviews*, has not been finalized. It is expected that the final SQMS will be issued in 2022. The content of the paragraphs in proposed SQMS No. 2 that are shown in this appendix may change between the time of issuance of this exposure draft and the issuance of the final SQMS.

component *auditor*). In these circumstances, the engagement quality reviewer may be assisted by individuals in accordance with paragraph 20. The guidance in paragraph A22 may be helpful when the engagement quality reviewer for the group audit is using assistants.

[No further amendment to proposed SQMS No. 2.]

Proposed Statement on Auditing Standards *Quality Management for Engagements Conducted in Accordance With Generally Accepted Auditing Standards* (proposed QM SAS)¹

23. This amendment to the proposed QM SAS would be effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025.

[No amendment to paragraphs 1–41.]

Scope of This Proposed SAS (Ref: par. 1)

A1. This proposed SAS applies to all audits of financial statements, including audits of group financial statements. ~~AU-C section 600, *Proposed Statement on Auditing Standards (SAS) Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)* addresses deals with~~ special considerations that apply to an audit of group financial statements, including when component auditors are involved *or when the group auditor makes reference to the audit of a referred-to auditor.* ~~AU-C section 600~~ **Proposed SAS Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)** also provides guidance on how to adapt and apply the requirements of this proposed SAS in an audit of group financial statements involving component auditors. ~~AU-C section 600~~ **Proposed SAS Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)** adapted as necessary in the circumstances, may also be useful in an audit of financial statements when the engagement team includes individuals from another firm. For example, ~~AU-C section 600~~ **proposed SAS Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)** may be useful when involving such an individual to attend a physical inventory count; inspect property, plant, and equipment; or perform audit procedures at a shared service center at a remote location.

[No amendment to paragraphs A2–A21.]

Definitions

¹ Proposed SAS *Quality Management for Engagements Conducted in Accordance With Generally Accepted Auditing Standards Engagements* has not been finalized. It is expected that the final SAS will be issued in 2022. The content of the paragraphs in the proposed QM SAS that are shown in this appendix may change between the time of issuance of this exposure draft and the issuance of the final SAS.

Engagement Team (Ref: par. 12d)

...

A22. *When joint auditors conduct an audit, the joint engagement partners and their engagement teams collectively constitute the “engagement partner” and “engagement team” for purposes of GAAS. This proposed QM SAS does not, however, deal with the relationship between joint auditors or the work that one joint auditor performs in relation to the work of the other joint auditor.*

A23. *Referred-to auditors are not members of the engagement team. Referred-to auditors are not component auditors.* ^{fn 25}

^{fn 25} *Paragraph .16 of Proposed SAS Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors).*

[Subsequent paragraphs and footnotes renumbered. No amendment to former paragraphs A22–A23.]

The Application of Firm Policies or Procedures by Members of the Engagement Team (Ref: par. 8)

~~A24~~**A26.** In particular, the firm’s policies or procedures may require the firm or the engagement partner to take different actions from those applicable to personnel when obtaining an understanding of whether an individual from another firm

- has the appropriate competence and capabilities to perform the audit engagement. For example, the individual would not be subject to the firm’s recruitment and training processes and, therefore, the firm’s policies or procedures may state that this determination can be made through other actions such as obtaining information from the other firm or a licensing or oversight body. Paragraphs ~~22 28~~ and ~~A47–A48~~**A71–A75** of ~~AU–C section 600~~**proposed SAS Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)** contain guidance on obtaining an understanding of the competence and capabilities of component auditors.
- understands the ethical requirements that are relevant to the group audit engagement. For example, the individual would not be subject to the firm’s training with regard to the firm’s policies or procedures for relevant ethical requirements. The firm’s policies or procedures may state that this understanding is obtained through other actions such as providing information, manuals, or guides containing the provisions of the relevant ethical requirements applicable to the audit engagement to the individual
- will confirm independence. For example, individuals who are not personnel may not be able to complete independence declarations directly on the firm’s independence systems. The firm’s policies or procedures may state that such individuals can

provide evidence of their independence in relation to the audit engagement in other ways, such as written confirmation.

~~A25~~ **A27.** When firm policies or procedures require specific activities to be undertaken in certain circumstances (for example, consultation on a particular matter), it may be necessary to communicate with individuals who are not personnel about what is expected of them to enable the engagement partner to comply with the firm’s policies or procedures. For example, in a group audit engagement, communicating the group auditor’s policies and procedures about matters subject to consultation to a component auditor enables the component auditor to determine which identified, difficult, or contentious matters that are relevant to the group financial statements to bring to the attention of the group *auditor engagement team*.

[No amendment to paragraphs A26–A52.]

Acceptance and Continuance of Client Relationships and Audit Engagements (Ref: par. 22–24)

...

~~A53~~ **A55.** Information obtained during the acceptance and continuance process may assist the engagement partner in complying with the requirements of this proposed SAS and making informed decisions about appropriate courses of action. Such information may include the following:

- Information about the size, complexity, and nature of the entity, including whether it is a group audit, the industry in which it operates, and the applicable financial reporting framework
- The entity’s timetable for reporting, such as at interim and final stages
- In relation to group audits, the nature of the control relationships between the parent and its *entities or business units* ~~components~~
- Whether there have been changes in the entity or in the industry in which the entity operates since the previous audit engagement that may affect the nature of resources required, as well as the manner in which the work of the engagement team will be directed, supervised, and reviewed

~~A54~~ **A56.** Information obtained during acceptance and continuance may also be relevant in complying with the requirements of other AU-C sections, as well as this proposed SAS, for example, with respect to the following:

- Establishing an understanding of the terms of the audit engagement, as required by AU-C section 210, *Terms of Engagement*²⁹³⁰
- Identifying and assessing risks of material misstatement, whether due to error or

fraud, in accordance with AU-C section 315 and AU-C section 240, *Consideration of Fraud in a Financial Statement Audit*

- Understanding the group, ~~its components~~, and ~~its~~ *their* environments, in the case of an audit of group financial statements in accordance with ~~AU-C section 600~~ **proposed SAS Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)** and directing, supervising, and reviewing the work of component auditors
- Determining whether, and how, to involve an auditor’s specialist in accordance with AU-C section 620
- The entity’s governance structure in accordance with AU-C section 260, *The Auditor’s Communication With Those Charged With Governance*, and AU-C section 265, *Communicating Internal Control Related Matters Identified in an Audit*

²⁹³⁰ [Footnote omitted for purposes of this proposed SAS.]

...

[No amendment to former paragraphs A55–A59.]

Engagement Resources (Ref: par. 25–28)

...

~~A60.~~**A62.** Resources for an audit engagement are primarily assigned or made available by the firm, although there may be circumstances when the engagement team directly obtains resources for the audit engagement. For example, this may be the case when a component auditor is required by statute, regulation, or for another reason to express an audit opinion on the financial statements of a component, and the component auditor is also appointed by component management to perform audit procedures on behalf of the group **auditor engagement team**.³⁰³¹ In such circumstances, the firm’s policies or procedures may require the engagement partner to take different actions, such as requesting information from the component auditor, to determine whether sufficient and appropriate resources are assigned or made available.

^{fn 3031} See paragraph ~~03 A10~~ of ~~AU-C section 600~~, **proposed SAS Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)**.

[No amendment to former paragraphs A61–A75.]

...

Insufficient or Inappropriate Resources (Ref: par. 27)

...

~~A76. In an audit of group financial statements, when there are insufficient or inappropriate resources in relation to work being performed at a component by a component auditor, the engagement partner may discuss the matter with the component auditor, management, or the firm to make sufficient and appropriate resources available.~~

...

Engagement Performance

...

The Engagement Partner's Review (Ref: par. 30–34)

...

~~A92~~**A91.** The engagement partner exercises professional judgment in identifying the areas of significant judgment made by the engagement team. The firm's policies or procedures may specify certain matters that are commonly expected to be significant judgments. Significant judgments in relation to the audit engagement may include matters related to the overall audit strategy and audit plan for undertaking the engagement, the execution of the engagement, and the overall conclusions reached by the engagement team. Examples follow:

- Matters related to planning the engagement, such as matters related to determining materiality
 - The composition of the engagement team, including
 - personnel using expertise in a specialized area of accounting or auditing
 - the use of personnel from service delivery centers
 - The decision to involve an auditor's specialist, including the decision to involve an external specialist
- The engagement team's consideration of information obtained in the acceptance and continuance process and proposed responses to that information
- The engagement team's risk assessment process, including situations in which consideration of inherent risk factors and the assessment of inherent risk requires significant judgment by the engagement team
- The engagement team's consideration of related party relationships and transactions and disclosures
- Results of the procedures performed by the engagement team on significant areas of the engagement, for example, conclusions concerning certain accounting estimates, accounting policies, or going concern considerations
- The engagement team's evaluation of the work performed by specialists and conclusions drawn therefrom

- In group audit situations
 - the proposed overall group audit strategy and group audit plan;
 - decisions about the involvement of component auditors, including how to direct and supervise them and review their work, ~~including, for example, when there are areas of higher assessed risk of material misstatement of the financial information of a component;~~ and
 - the evaluation of work performed by component auditors and the conclusions drawn therefrom
- How matters affecting the overall audit strategy and audit plan have been addressed
- The significance and disposition of corrected and uncorrected misstatements identified during the engagement
- The proposed audit opinion and matters to be communicated in the auditor’s report, for example, key audit matters, or a “Material Uncertainty Related to Going Concern” paragraph

[No further amendment to proposed SAS *Quality Management for Engagements Conducted in Accordance With Generally Accepted Auditing Standards.*]

APPENDIX 2

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

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

Introduction

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

Note: AS 2101 establishes requirements regarding serving as the lead auditor.⁵

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

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

¹ The term "lead auditor," as used in this standard, has the same meaning as defined in Appendix A of AS 2101, *Audit Planning*.

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

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

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

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

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

Objectives

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

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

.03 The lead auditor should determine that audit procedures are performed, in coordination with the referred-to auditor, to test and evaluate the consolidation or combination of the financial statements of the business units⁷ audited by the referred-to auditor into the company's financial statements.⁸ Matters affecting such consolidation or combination include, for example, intercompany transactions.

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

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

- a. Independent under the requirements of the PCAOB and the Securities and Exchange Commission ("SEC"); and
- b. Duly licensed to practice under the laws of the jurisdiction that apply to the work of the referred-to auditor.

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

- a. The referred-to auditor has represented that it has performed the audit and issued the auditor's report in accordance with the standards of the PCAOB,⁹

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

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

⁹ AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, and AS 3105, *Departures from Unqualified Opinions and Other Reporting*

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

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

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

Circumstances, apply to auditors' reports issued for audits of historical financial statements that are intended to present financial position, results of operations, and cash flows in conformity with the applicable financial reporting framework. AS 2201 applies to auditors' reports issued for audits of management's assessment of the effectiveness of internal control over financial reporting that are integrated with an audit of the financial statements. In situations where the referred-to auditor is not registered with the PCAOB, the requirements that the auditor's report state that the auditor is registered with the PCAOB (see AS 3101.06 and .09g, and AS 2201.85A and .85Dd) do not apply to a referred-to auditor's report. Disclosure in the auditor's report that a firm is not registered with the PCAOB (or omission that the firm is registered) does not relieve that firm of its obligation to register when required.

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

statements and, if applicable, internal control over financial reporting; or

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

- c. Withdraw from the engagement.

Making Reference in the Lead Auditor's Report

.08 When the lead auditor divides responsibility for the audit with the referred-to auditor, the lead auditor's report must make reference to the audit and auditor's report of the referred-to auditor. The lead auditor's report (or reports, if the lead auditor chooses to issue separate reports on the company's financial statements and on internal control over financial reporting) should:

- a. Indicate clearly, in the Opinion on the Financial Statements and, if applicable, Internal Control over Financial Reporting and Basis for Opinion sections, the division of responsibility between that portion of the company's financial statements, and if applicable, internal control over financial reporting, covered by the lead auditor's own audit and that covered by the audit of the referred-to auditor;
- b. Identify the referred-to auditor by name and refer to the auditor's report of the referred-to auditor when describing the scope of the audit and when expressing an opinion;¹² and
- c. Disclose the magnitude of the portion of the company's financial statements, and if applicable, internal control over financial reporting, audited by the referred-to auditor. This may be done by stating the dollar amounts or percentages of total assets, total revenues, or other appropriate criteria necessary to identify the portion of the company's financial statements audited by the referred-to auditor.

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

¹¹ See AS 3105, which discusses the circumstances that may require the auditor to depart from the auditor's unqualified report. For integrated audits, see also Appendix C, *Special Reporting Situations*, of AS 2201.

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

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

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

¹³ See, e.g., AS 2201.C10.

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

Appendix A – Definitions

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

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

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

Example 1: The Lead Auditor Chooses¹ to Issue a Combined Report on the Financial Statements and Internal Control Over Financial Reporting, Both of Which Refer to the Reports of the Referred-to Auditor

Report of Independent Registered Public Accounting Firm

To the shareholders and the board of directors of X Company

Opinions on the Financial Statements and Internal Control Over Financial Reporting

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

In our opinion, based on our audits and the report of Firm ABC, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 20X2 and 20X1, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 20X2, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, based on our audits and the report of Firm ABC, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 20X2, based on [*Identify control criteria, for example, “criteria established in Internal Control—Integrated Framework: 20XX issued by COSO.”*].

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

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

Basis for Opinion

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

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating

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

the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits and the report of Firm ABC provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control Over Financial Reporting

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

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

Critical Audit Matters [if applicable]

[Include critical audit matters]

[Signature]

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

[City and State or Country]

[Date]

Example 2: The Lead Auditor Chooses to Issue Separate Reports on the Financial Statements and Internal Control Over Financial Reporting, and Makes Reference to the Referred-to Auditor Only in the Report on the Financial Statements³

Report of Independent Registered Public Accounting Firm

To the shareholders and the board of directors of X Company

Opinion on the Financial Statements

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

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

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

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

the report of Firm ABC.⁴

Basis for Opinion

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

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

Critical Audit Matters [if applicable]

[Include critical audit matters]

[Signature]

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

[City and State or Country]

[Date]

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

Examples of an Alternative Paragraph (Which Precedes the Basis for Opinion Section) When the Financial Statements Audited by the Referred-to Auditor Were Prepared Using a Financial Reporting Framework that Differs from the Framework Used to Prepare the Financial Statements Audited by the Lead Auditor

Example 3: Conversion Adjustments Audited by the Lead Auditor

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

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

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

PCAOB AS 1105 — Audit Evidence

...

Appendix B — Audit Evidence Regarding Valuation of Investments Based on Investee Financial Results**.B1**

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

.B2

If in the auditor's judgment additional evidence is needed, the auditor should perform procedures to gather such evidence. For example, the auditor may conclude that additional evidence is needed because of its concerns about the professional reputation or independence of the investee's auditor, significant differences in fiscal year-ends, significant differences in accounting principles, changes in ownership, changes in conditions affecting the use of the equity method, or the materiality of the investment to the investor's financial position or results of operations. Examples of procedures the auditor may perform are reviewing information in the investor's files that relates to the investee such as investee minutes and budgets and cash flows information about the investee and making inquiries of investor management about the investee's financial results.

.B3

If the investee's financial statements are not audited, or if the investee auditor's report is not satisfactory to the investor's auditor for this purpose, the investor's auditor should apply, or should request that the investor arrange with the investee to have another auditor apply, appropriate auditing procedures to such financial statements, considering the materiality of the investment in relation to the financial statements of the investor.

.B4

If the carrying amount of the security reflects factors that are not recognized in the investee's financial statements or fair values of assets that are materially different from the investee's carrying amounts, the auditor should obtain sufficient appropriate evidence in support of these amounts.

Note: The auditor should look to the requirements of AS 2501, *Auditing Accounting Estimates, Including Fair Value Measurements*, and the applicable financial reporting framework with respect to auditing fair value measurements and evaluating asset impairment.

.B5

There may be a time lag in reporting between the date of the financial statements of the investor and that of the investee. A time lag in reporting should be consistent from period to period. If a time lag between the date of the entity's financial statements and those of the investee has a material effect on the entity's financial statements, the auditor should determine whether the entity's management has properly considered the lack of comparability. The effect may be material, for example, because the time lag is not consistent with the prior period in comparative statements or because a significant transaction occurred during the time lag. If a change in time lag occurs that has a material effect on the investor's financial statements, an explanatory paragraph, including an appropriate title, should be added to the auditor's report because of the change in reporting period.^{fn 2}

.B6

The auditor should evaluate management's conclusion about the need to recognize an impairment loss for a decline in the security's fair value below its carrying amount that is other than temporary. In addition, with respect to subsequent events and transactions of the investee occurring after the date of the investee's financial statements but before the date of the investor auditor's report, the auditor should read available interim financial statements of the investee and make appropriate inquiries of the investor to identify subsequent events and transactions that are material to the investor's financial statements. Such events or transactions of the type contemplated in paragraphs .05–.06 of AS 2801, *Subsequent Events*, should be disclosed in the notes to the investor's financial statements and (where applicable) labeled as unaudited information. For the purpose of recording the investor's share of the investee's results of operations, recognition should be given to events or transactions of the type contemplated in AS 2801.03.

.B7

Evidence relating to material transactions between the entity and the investee should be obtained to evaluate (a) the propriety of the elimination of unrealized profits and losses on transactions between the entity and the investee that is required when the equity method of accounting is used to account for an investment under the applicable financial reporting framework and (b) the adequacy of disclosures about material related party transactions.

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

fn 2 See AS 2820, *Evaluating Consistency of Financial Statements*.

AU-C Section 501 — Audit Evidence — Specific Considerations for Selected Items

Source: SAS No. 122; SAS No. 136; SAS No. 142; SAS No. 143; SAS No. 144.

Effective for audits of financial statements for periods ending on or after December 15, 2012, unless otherwise indicated.

NOTE

In October 2021, the Auditing Standards board issued Statement on Auditing Standards No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in [appendix G](#) of section 315 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses specific considerations by the auditor in obtaining sufficient appropriate audit evidence, in accordance with [section 330](#), *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*; [section 500A](#), *Audit Evidence*; section 540, *Auditing Accounting Estimates and Related Disclosures*; and other relevant AU-C sections, regarding certain aspects of (a) investments in securities and derivative instruments; (b) inventory; (c) litigation, claims, and assessments involving the entity; (d) segment information in an audit of financial statements; and (e) use of management’s specialists. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

Effective Date

.02 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.

Objective

.03 The objective of the auditor is to obtain sufficient appropriate audit evidence regarding the

- a. valuation of investments in securities and derivative instruments;
- b. existence and condition of inventory;
- c. completeness of litigation, claims, and assessments involving the entity;
- d. presentation and disclosure of segment information, in accordance with the applicable financial reporting framework; and
- e. work of management’s specialists.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

Definition

.04 For purposes of GAAS, the following term has the meaning attributed as follows:

Management's specialist. An individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements.

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142.]

Requirements

Investments in Securities and Derivative Instruments (Ref: [par. .A1-.A4](#))

Investments in Securities When Valuations Are Based on the Investee's Financial Results (Excluding Investments Accounted for Using the Equity Method of Accounting)

.05 When investments in securities are valued based on an investee's financial results, excluding investments accounted for using the equity method of accounting, the auditor should obtain audit evidence regarding the investee's financial results, including as applicable in the circumstances, performing the following procedures: (Ref: [par. .A5-.A9](#))

- a. Obtain and read available financial statements of the investee and the accompanying audit report, if any, including determining whether the report of the other auditor is satisfactory for this purpose.
- b. If the investee's financial statements are not audited, or if the audit report on such financial statements is not satisfactory to the auditor, apply, or request that the investor entity arrange with the investee to have another auditor apply, appropriate auditing procedures to such financial statements, considering the materiality of the investment in relation to the financial statements of the investor entity.
- c. If the carrying amount of the investment reflects factors that are not recognized in the investee's financial statements or fair values of assets that are materially different from the investee's carrying amounts, obtain sufficient appropriate audit evidence regarding such amounts.
- d. If the difference between the financial statement period of the entity and the investee has or could have a material effect on the entity's financial statements, determine whether the entity's management has properly considered the lack of comparability and determine the effect, if any, on the auditor's report. (Ref: [par. .A10](#))

If the auditor is not able to obtain sufficient appropriate audit evidence in support of the investee's financial results because of an inability to perform appropriate procedures, the auditor should determine the effect on the auditor's opinion, in accordance with [section 705, Modifications to the Opinion in the Independent Auditor's Report](#). [Paragraph renumbered by the issuance of SAS No. 142, July 2020. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

.06 With respect to subsequent events and transactions of the investee occurring after the date of the investee's financial statements but before the date of the auditor's report, the auditor should obtain and read available interim financial statements of the investee and make appropriate inquiries of management of the investor to identify such events and transactions that may be material to the investor's financial statements and that may need to be recognized or disclosed in the investor's financial statements. (Ref: [par. .A11](#)) [Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

[Investments in Derivative Instruments and Securities Measured or Disclosed at Fair Value] **[.07–.11]**

[Paragraphs deleted by the issuance of SAS No. 143, July 2020.]^[fn.1]

Inventory

.12 If inventory is material to the financial statements, the auditor should obtain sufficient appropriate audit evidence regarding the existence and condition of inventory^{fn.2} by

- a. attending physical inventory counting, unless impracticable, to (Ref: [par. .A21–.A23](#))
 - i. evaluate management’s instructions and procedures for recording and controlling the results of the entity’s physical inventory counting, (Ref: [par. .A24](#))
 - ii. observe the performance of management’s count procedures, (Ref: [par. .A25](#))
 - iii. inspect the inventory, and (Ref: [par. .A26](#))
 - iv. perform test counts and (Ref: [par. .A27](#))
- b. performing audit procedures over the entity’s final inventory records to determine whether they accurately reflect actual inventory count results. (Ref: [par. .A28–.A31](#))

[Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

.13 If physical inventory counting is conducted at a date other than the date of the financial statements, the auditor should, in addition to the procedures required by [paragraph .12](#), perform audit procedures to obtain audit evidence about whether changes in inventory between the count date and the date of the financial statements are recorded properly. (Ref: [par. .A32–.A34](#)) [Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

.14 If the auditor is unable to attend physical inventory counting due to unforeseen circumstances, the auditor should make or observe some physical counts on an alternative date and perform audit procedures on intervening transactions. [Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

.15 If attendance at physical inventory counting is impracticable, the auditor should perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory. If it is not possible to do so, the auditor should modify the opinion in the auditor’s report, in accordance with [section 705](#). (Ref: [par. .A35–.A37](#)) [Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

.16 If inventory under the custody and control of a third party is material to the financial statements, the auditor should obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following:

- a. Request confirmation from the third party regarding the quantities and condition of inventory held on behalf of the entity (Ref: [par. .A38](#))
- b. Perform inspection or other audit procedures appropriate in the circumstances (Ref: [par. .A39](#))

[Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

Litigation, Claims, and Assessments

.17 The auditor should design and perform audit procedures to identify litigation, claims, and assessments involving the entity that may give rise to a risk of material misstatement, including (Ref: [par. .A40-.A46](#))

- a. inquiring of management and, when applicable, others within the entity, including in-house legal counsel;
- b. obtaining from management a description and evaluation of litigation, claims, and assessments that existed at the date of the financial statements being reported on and during the period from the date of the financial statements to the date the information is furnished, including an identification of those matters referred to legal counsel;^{fn 3}
- c. reviewing minutes of meetings of those charged with governance; documents obtained from management concerning litigation, claims, and assessments; and correspondence between the entity and its external legal counsel; and
- d. reviewing legal expense accounts and invoices from external legal counsel.

[Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

.18 For actual or potential litigation, claims, and assessments identified based on the audit procedures required in [paragraph .17](#), the auditor should obtain audit evidence relevant to the following factors:

- a. The period in which the underlying cause for legal action occurred
- b. The degree of probability of an unfavorable outcome
- c. The amount or range of potential loss

[Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

Communication With the Entity's Legal Counsel

.19 Unless the audit procedures required by [paragraph .17](#) indicate that no actual or potential litigation, claims, or assessments that may give rise to a risk of material misstatement exist, the auditor should, in addition to the procedures required by other AU-C sections, seek direct communication with the entity's external legal counsel. The auditor should do so through a letter of inquiry prepared by management and sent by the auditor requesting the entity's external legal counsel to communicate directly with the auditor. (Ref: [par. .A41](#) and [.A47-.A64](#)) [Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

.20 In addition to the direct communications with the entity's external legal counsel referred to in [paragraph .19](#), the auditor should, in cases when the entity's in-house legal counsel has the responsibility for the entity's litigation, claims, and assessments, seek direct communication with the entity's in-house legal counsel through a letter of inquiry similar to the letter referred to in [paragraph .19](#). Audit evidence obtained from in-house legal counsel in this manner is not, however, a substitute for the auditor seeking direct communication with the entity's external legal counsel, as described in [paragraph .19](#). (Ref: [par. .A65](#)) [Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

.21 The auditor should document the basis for any determination not to seek direct communication with the entity's legal counsel, as required by [paragraphs .19-.20](#). [Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

.22 The auditor should request management to authorize the entity's legal counsel to discuss applicable matters with the auditor. [Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

.23 As described in [paragraphs .19-.20](#), the auditor should request, through letter(s) of inquiry, the entity's legal counsel to inform the auditor of any litigation, claims, assessments, and unasserted claims that the counsel is aware of, together with an assessment of the outcome of the litigation, claims, and assessments, and an estimate of the financial implications, including costs involved. Each letter of inquiry should include, but not be limited to, the following matters: (Ref: [par. .A89](#))

- a. Identification of the entity, including subsidiaries, and the date of the audit
- b. A list prepared by management (or a request by management that the legal counsel prepare a list) that describes and evaluates pending or threatened litigation, claims, and assessments with respect to which the legal counsel has been engaged and to which the legal counsel has devoted substantive attention on behalf of the company in the form of legal consultation or representation
- c. A list prepared by management that describes and evaluates unasserted claims and assessments that management considers to be probable of assertion and that, if asserted, would have at least a reasonable possibility of an unfavorable outcome with respect to which the legal counsel has been engaged and to which the legal counsel has devoted substantive attention on behalf of the entity in the form of legal consultation or representation
- d. Regarding each matter listed in item *b*, a request that the legal counsel either provide the following information or comment on those matters on which the legal counsel's views may differ from those stated by management, as appropriate:
 - i. A description of the nature of the matter, the progress of the case to date, and the action that the entity intends to take (for example, to contest the matter vigorously or to seek an out-of-court settlement)
 - ii. An evaluation of the likelihood of an unfavorable outcome and an estimate, if one can be made, of the amount or range of potential loss (Ref: [par. .A66](#))
 - iii. With respect to a list prepared by management (or by the legal counsel at management's request), an identification of the omission of any pending or threatened litigation, claims, and assessments or a statement that the list of such matters is complete
- e. Regarding each matter listed in item *c*, a request that the legal counsel comment on those matters on which the legal counsel's views concerning the description or evaluation of the matter may differ from those stated by management
- f. A statement that management understands that whenever, in the course of performing legal services for the entity with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, the legal counsel has formed a professional conclusion that the entity should disclose or consider disclosure concerning such possible claim or assessment, the legal counsel, as a matter of professional responsibility to the entity, will so advise the entity and will consult with the entity concerning the question of such disclosure and the requirements of the applicable financial reporting framework (for example, the requirements of Financial Accounting Standards Board [FASB] *Accounting Standards Codification* [ASC] 450, *Contingencies*)
- g. A request that the legal counsel confirm whether the understanding described in item *f* is correct
- h. A request that the legal counsel specifically identify the nature of, and reasons for, any limitation on the response
- i. A request that the legal counsel specify the effective date of the response

[Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

.24 When the auditor is aware that an entity has changed legal counsel or that the legal counsel previously engaged by the entity has resigned, the auditor should consider making inquiries of management or others about the reasons such legal counsel is no longer associated with the entity. (Ref: [par. .A56](#)) [Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

.25 The auditor should modify the opinion in the auditor's report, in accordance with [section 705](#), if (Ref: [par. .A57-.A66](#))

- a. the entity's legal counsel refuses to respond appropriately to the letter of inquiry and the auditor is unable to obtain sufficient appropriate audit evidence by performing alternative audit procedures or
- b. management refuses to give the auditor permission to communicate or meet with the entity's external legal counsel.

[Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

Segment Information

.26 The auditor should obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information, in accordance with the applicable financial reporting framework, by (Ref: [par. .A67-.A68](#))

- a. obtaining an understanding of the methods used by management in determining segment information and (Ref: [par. .A69](#))
 - i. evaluating whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework and
 - ii. when appropriate, testing the application of such methods and
- b. performing analytical procedures or other audit procedures appropriate in the circumstances.

[Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

Management's Specialist

.27 If information to be used as audit evidence has been prepared using the work of a management's specialist, the auditor should, to the extent necessary, taking into account the significance of that specialist's work for the auditor's purposes, perform the following: (Ref: [par. .A70-.A72](#))

- a. Evaluate the competence, capabilities, and objectivity of that specialist (Ref: [par. .A73-.A79](#))
- b. Obtain an understanding of the work of that specialist (Ref: [par. .A80-.A83](#))
- c. Evaluate the appropriateness of that specialist's work as audit evidence for the relevant assertion (Ref: [par. .A84-.A88](#))

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

Application and Other Explanatory Material

Investments in Securities and Derivative Instruments (Ref: [par. .05-.06](#))

.A1

[Section 540](#) addresses the auditor's responsibilities relating to accounting estimates, including fair value accounting estimates and related disclosures, in an audit of financial statements. This section addresses aspects relating to auditing valuation of investments in securities and derivative instruments that are incremental to [section 540](#). [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

.A2

Evaluating audit evidence for assertions about investments in securities and derivative instruments often involves professional judgment because the assertions, especially those about valuation, are based on highly subjective assumptions or are particularly sensitive to changes in the underlying circumstances. Valuation assertions relating to investments in securities and derivative instruments may be based on assumptions about the occurrence of future events for which expectations are difficult to develop or on assumptions about conditions expected to exist over a long period (for example, default rates or prepayment rates). Accordingly, competent persons could reach different conclusions about estimates of fair values or estimates of ranges of fair values. Professional judgment also may be necessary when evaluating audit evidence for assertions based on features of the security or derivative and the requirements of the applicable financial reporting framework, including underlying criteria for hedge accounting, which may be complex. For example, determining the fair value of a structured note may require consideration of a variety of features of the note that react differently to changes in economic conditions. In addition, one or more other derivatives may be designated to hedge changes in cash flows under the note. Evaluating audit evidence about the fair value of the note, the determination of whether the hedge is highly effective, and the allocation of changes in fair value to earnings and other comprehensive income requires professional judgment. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

[.A3]

[Paragraph renumbered and deleted by issuance of SAS No. 143, July 2020]

Investments in Securities When Valuations Are Based on Cost

.A4

Procedures to obtain evidence about the valuation of securities that are recorded at cost may include inspection of documentation of the purchase price, confirmation with the issuer or holder of those securities, and testing discount or premium amortization either by recomputation or through the use of analytical procedures. [Revised, February 2017, to better reflect the AICPA Council Resolution designating the PCAOB to promulgate technical standards. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Investments in Securities When Valuations Are Based on the Investee's Financial Results (Excluding Investments Accounted for Using the Equity Method of Accounting) (Ref: [par. .05-.06](#))

.A5

[Section 600](#), *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*, addresses auditing investments accounted for using the equity method of accounting. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A6

For valuations based on an investee's financial results (excluding investments accounted for using the equity method of accounting), obtaining and reading the financial statements of the investee that have been audited by an auditor whose report is satisfactory may be sufficient for the purpose of obtaining sufficient appropriate audit evidence of the amount used in the estimate. In determining whether the report of another auditor is satisfactory, the auditor may perform procedures such as making inquiries regarding the professional reputation and standing of the other auditor, visiting the other auditor, discussing the audit procedures followed and the results thereof, and reviewing the audit plan and audit documentation of the other auditor. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

.A7

After obtaining and reading the audited financial statements of an investee, the auditor may conclude that additional audit procedures are necessary to obtain sufficient appropriate audit evidence, for example, when the date of the audited financial statements is different from the investor's measurement date. Further examples for when the auditor may conclude that additional audit evidence is needed include significant differences in accounting principles, changes in ownership, or the significance of the investment to the investor's financial position or results of operations. Examples of procedures that the auditor may perform are reviewing information in the investor's files that relates to the investee, such as investee minutes and budgets, and investee cash flow information and making inquiries of investor management about the investee's financial results. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

.A8

The auditor may need to obtain evidence relating to transactions between the entity and investee to evaluate

- a. the propriety of the elimination of unrealized profits and losses on transactions between the entity and investee, if applicable, and
- b. the adequacy of disclosures about material related party transactions or relationships.

[Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A9

[Section 540](#) addresses auditing fair value accounting estimates. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

.A10

The date of the investor's financial statements and those of the investee may be different. If the difference between the date of the entity's financial statements and those of the investee has or could have a material effect on the entity's financial statements, the auditor is required, in accordance with [paragraph .05d](#), to determine whether the entity's management has properly considered the lack of comparability. The effect may be material, for example, because the difference between the financial statement period ends of the entity and investee is not consistent with the prior period in comparative statements or because a significant transaction occurred during the time period between the financial statement period end of the entity and investee. If a change in the difference between the financial statement period end of the entity and investee has a material effect on the investor's financial statements, the auditor may be required, in accordance with [section 708, Consistency of Financial Statements](#), to add an emphasis-of-matter paragraph to the auditor's report because the

comparability of financial statements between periods has been materially affected by a change in reporting period. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A11

[Section 560](#), *Subsequent Events and Subsequently Discovered Facts*, addresses the auditor's responsibilities relating to subsequent events and subsequently discovered facts in an audit of financial statements. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

[Investments in Derivative Instruments and Securities Measured or Disclosed at Fair Value (Ref: par. .07–.09)] [.A12–.A20]

[Paragraphs renumbered and deleted by the issuance of SAS No. 143, July 2020.]^[fn 4-fn 6]

Inventory

Attendance at Physical Inventory Counting (Ref: [par. .12a](#))

.A21

Management ordinarily establishes procedures under which inventory is physically counted at least once per year to serve as a basis for the preparation of the financial statements and, if applicable, to ascertain the reliability of the entity's perpetual inventory system. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A22

Attendance at physical inventory counting involves

- inspecting the inventory to ascertain its existence and evaluate its condition and performing test counts,
- observing compliance with management's instructions and the performance of procedures for recording and controlling the results of the physical inventory count, and
- obtaining audit evidence about the reliability of management's count procedures.

These procedures may serve as tests of controls or substantive procedures, or both, depending on the auditor's risk assessment, planned approach, and the specific procedures carried out. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A23

Matters relevant in planning attendance at physical inventory counting (or in designing and performing audit procedures pursuant to [paragraphs .12–.16](#)) include, for example, the following:

- The risks of material misstatement related to inventory.
- The control risk related to inventory.
- Whether adequate procedures are expected to be established and proper instructions issued for physical inventory counting.
- The timing of physical inventory counting.
- Whether the entity maintains a perpetual inventory system.
- The locations at which inventory is held, including the materiality of the inventory and the risks of material misstatement at different locations, in deciding at which locations attendance is appropriate. [Section 600](#) addresses the involvement of component auditors and, accordingly, may be relevant if such involvement is with regard to attendance of physical inventory counting at a remote location.
- Whether the assistance of an auditor's specialist is needed. [Section 620](#), *Using the Work of an Auditor's Specialist*, addresses the use of an auditor's specialist to assist the auditor in obtaining sufficient appropriate audit evidence.

[Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Evaluate Management's Instructions and Procedures (Ref: [par. .12a\(i\)](#))

.A24

Matters relevant in evaluating management's instructions and procedures for recording and controlling the physical inventory counting include whether they address, for example, the following:

- The application of appropriate control activities (for example, the collection of used physical inventory count records, accounting for unused physical inventory count records, and count and recount procedures)
- The accurate identification of the stage of completion of work in progress; slow moving, obsolete, or damaged items; and inventory owned by a third party (for example, on consignment)
- The procedures used to estimate physical quantities, when applicable, such as may be needed in estimating the physical quantity of a coal pile
- Control over the movement of inventory between areas and the shipping and receipt of inventory before and after the cut-off date

[Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Observe the Performance of Management's Count Procedures (Ref: [par. .12a\(ii\)](#))

.A25

Observing the performance of management's count procedures (for example, those relating to control over the movement of inventory before, during, and after the count) assists the auditor in obtaining audit evidence that management's instructions and count procedures are designed and implemented adequately. In addition, the auditor may obtain copies of cutoff information, such as details of the movement of inventory, to assist the auditor in performing audit procedures over the accounting for such movements at a later date. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Inspect the Inventory (Ref: [par. .12a\(iii\)](#))

.A26

Inspecting inventory when attending physical inventory counting assists the auditor in ascertaining the existence of the inventory (though not necessarily its ownership) and in identifying obsolete, damaged, or aging inventory. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Perform Test Counts (Ref: [par. .12a\(iv\)](#))

.A27

Performing test counts (for example, by tracing items selected from management's count records to the physical inventory and tracing items selected from the physical inventory to management's count records) provides audit evidence about the completeness and accuracy of those records. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A28

In addition to recording the auditor's test counts, obtaining copies of management's completed physical inventory count records assists the auditor in performing subsequent audit procedures to determine whether the entity's final inventory records accurately reflect actual inventory count results. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Using the Work of an External Inventory-Taking Firm

.A29

Management may engage external organizations that have expertise in the taking of physical inventories to count, list, price, and subsequently compute the total dollar amount of inventory on hand at the date of the physical count. For example, such external inventory-taking firms are often used by entities such as retail stores, hospitals, and automobile dealers. [Paragraph renumbered by the issuance of SAS No. 143, July 2020. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A30

The report of an external inventory-taking firm about the work it performed does not, by itself, provide the auditor with sufficient appropriate audit evidence. [Paragraph .12](#) requires the auditor, if inventory is material to the financial statements, to perform certain procedures regarding the existence and condition of inventory.^{[fn 71](#)} The auditor may, for example, examine the external inventory-taking firm's program, observe its procedures and controls, make or observe some physical counts of the inventory, recompute calculations of the submitted inventory on a test basis, and apply appropriate tests to the intervening transactions. [Paragraph renumbered by the issuance of SAS No. 143, July 2020. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A31

Although the auditor may adjust the extent of the work on the physical count of inventory because of the work of an external inventory-taking firm, any restriction imposed on the auditor such that the auditor is unable to perform the procedures that the auditor considers necessary is a scope limitation. In such cases, [section 705](#) requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation. [Paragraph renumbered by the issuance of SAS No. 143, July 2020. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

Physical Inventory Counting Conducted Other Than at the Date of the Financial Statements (Ref: [par. .13](#))

.A32

For practical reasons, the physical inventory counting may be conducted at a date, or dates, other than the date of the financial statements. This may be done irrespective of whether management determines inventory quantities by an annual physical inventory counting or maintains a perpetual inventory system. In either case, the effectiveness of the design, implementation, and maintenance of controls over changes in inventory determines whether the conduct of physical inventory counting at a date (or dates) other than the date of the financial statements is appropriate for audit purposes. [Section 330](#) addresses substantive procedures performed at an interim date.^{[fn 8](#)} [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A33

When a perpetual inventory system is maintained, management may perform physical counts or other tests to ascertain the reliability of inventory quantity information included in the entity's perpetual inventory records. In some cases, management or the auditor may identify differences between the perpetual inventory records and actual physical inventory quantities on hand; this may indicate that the controls over changes in inventory are not operating effectively. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A34

Relevant matters for consideration when designing audit procedures to obtain audit evidence about whether changes in inventory amounts between the count date, or dates, and the final inventory records are recorded properly include the following:

- Whether the perpetual inventory records are properly adjusted
- Reliability of the entity's perpetual inventory records
- Reasons for significant differences between the information obtained during the physical count and the perpetual inventory records

[Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Attendance at Physical Inventory Counting Is Impracticable (Ref: [par. .15](#)) .A35

In some cases, attendance at physical inventory counting may be impracticable. This may be due to factors such as the nature and location of the inventory (for example, when inventory is held in a location that may pose threats to the safety of the auditor). The matter of general inconvenience to the auditor, however, is not sufficient to support a decision by the auditor that attendance is impracticable. Further, as explained in [section 200](#), *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, the matter of difficulty, time, or cost involved is not, in itself, a valid basis for the auditor to omit an audit procedure for which no alternative exists or to be satisfied with audit evidence that is less than persuasive.

[Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A36

In some cases, when attendance is impracticable, alternative audit procedures (for example, observing a current physical inventory count and reconciling it to the opening inventory quantities or inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting) may provide sufficient appropriate audit evidence about the existence and condition of inventory. If the audit covers the current period and one or more periods for which the auditor had not observed or made some physical counts of prior inventories, alternative audit procedures, such as tests of prior transactions or reviews of the records of prior counts, may provide sufficient appropriate audit evidence about the prior inventories. The effectiveness of the alternative procedures that an auditor may perform is affected by the length of the period that the alternative procedures cover. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A37

In other cases, however, it may not be possible to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by performing alternative audit procedures. In such cases, [section 705](#) requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation. In addition, [section 510](#), *Opening Balances — Initial Audit Engagements, Including Reaudit Engagements*, addresses the auditor's procedures regarding inventory opening balances in initial audit engagements.^{fn.9} [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Inventory Under the Custody and Control of a Third Party

Confirmation (Ref: [par. .16a](#))

.A38

[Section 505](#), *External Confirmations*, addresses external confirmation procedures. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Other Audit Procedures (Ref: [par. .16b](#))

.A39

Depending on the circumstances (for example, when information is obtained that raises doubt about the integrity and objectivity of the third party), the auditor may consider it appropriate to perform other audit procedures instead of, or in addition to, confirmation with the third party. Examples of other audit procedures include the following:

- Attending, or arranging for another auditor to attend, the third party's physical counting of inventory, if practicable
- Obtaining another auditor's report on the adequacy of the third party's internal control for ensuring that inventory is properly counted and adequately safeguarded
- Inspecting documentation regarding inventory held by third parties (for example, warehouse receipts)
- Requesting confirmation from other parties when inventory has been pledged as collateral

[Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Litigation, Claims, and Assessments

Completeness of Litigation, Claims, and Assessments (Ref: [par. .17](#))

.A40

Litigation, claims, and assessments involving the entity may have a material effect on the financial statements and, thus, may be required to be recognized, measured, or disclosed in the financial statements. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A41

Other legal matters involving the entity may not have a material effect on the entity's financial statements and, accordingly, would not give rise to risks of material misstatement. Examples of such other legal matters may be

- matters unrelated to actual or potential litigation, claims, or assessments, such as consulting services related to real estate or potential merger and acquisition transactions;
- matters in which the entity records indicate that management or the legal counsel has not devoted substantive attention to the matter;
- matters in which the entity's insurance coverage exceeds the amount of the actual or potential litigation, claim, or assessment sought against the entity; or
- matters that are clearly trivial to the financial statements.

[Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A42

Management is responsible for adopting policies and procedures to identify, evaluate, and account for litigation, claims, and assessments as a basis for the preparation of financial statements, in accordance with the requirements of the applicable financial reporting framework. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A43

Management is the primary source of information about events or conditions considered in the financial accounting for, and reporting of, litigation, claims, and assessments because these matters are within the direct knowledge and, often, control of management. Accordingly, the auditor's procedures with respect to litigation, claims, and assessments include the following:

- Making inquiries of management as required by [paragraph .17a](#), which may include a discussion about the policies and procedures adopted for identifying, evaluating, and accounting for litigation, claims, and assessments involving the entity that may give rise to a risk of material misstatement

- Obtaining written representations from management, in accordance with [section 580](#), *Written Representations*, that all known actual or possible litigation, claims, and assessments whose effects should be considered when preparing the financial statements have been disclosed to the auditor and accounted for and disclosed in accordance with the applicable financial reporting framework^{fn 10}

[Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A44

In addition to the procedures identified in [paragraph .17](#), other relevant procedures include, for example, using information obtained through risk assessment procedures carried out as part of obtaining an understanding of the entity and its environment to assist the auditor to become aware of litigation, claims, and assessments involving the entity. Examples of such procedures are as follows:

- Reading minutes of meetings of stockholders; directors; governing bodies of governmental entities; and appropriate committees held during, and subsequent to, the period being audited
- Reading contracts, loan agreements, leases, correspondence from taxing or other governmental agencies, and similar documents
- Obtaining information concerning guarantees from bank confirmation forms
- Inspecting other documents for possible guarantees by the entity

[Section 315A](#), *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, requires the auditor to obtain an understanding of the entity and its environment.^{fn 11} In addition, [section 250](#), *Consideration of Laws and Regulations in an Audit of Financial Statements*, requires the auditor to obtain an understanding of the entity's legal and regulatory framework applicable to the entity and industry or sector in which the entity operates and how the entity is complying with that framework. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A45

Audit evidence obtained for purposes of identifying litigation, claims, and assessments that may give rise to a risk of material misstatement also may provide audit evidence regarding other relevant considerations, such as valuation or measurement, regarding litigation, claims, and assessments. [Section 540](#) establishes requirements and provides guidance relevant to the auditor's consideration of litigation, claims, and assessments requiring accounting estimates or related disclosures in the financial statements. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A46

This section addresses inquiries of the entity's legal counsel with whom management has consulted. If management has not consulted legal counsel, the auditor would rely on the procedures required by [paragraph .17](#) to identify litigation, claims, and assessments involving the entity, which may give rise to a risk of material misstatement, and the written representation of management regarding litigation, claims, and assessments, as required by [section 580](#). [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Communication With the Entity's Legal Counsel (Ref: [par. .19-.25](#))

.A47

An auditor ordinarily does not possess legal skills and, therefore, cannot make legal judgments concerning information coming to the auditor's attention. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A48

Direct communication with the entity's legal counsel assists the auditor in obtaining sufficient appropriate audit evidence about whether potentially material litigation, claims, and assessments are

known and management's estimates of the financial implications, including costs, are reasonable. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A49

The American Bar Association (ABA) has approved *Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information* (the ABA statement), which explains the concerns of the legal counsel and the nature of the limitations that an auditor is likely to encounter in connection with seeking direct communication with the entity's legal counsel about litigation, claims, assessments, and unasserted claims.^{fn 12} [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A50

A letter of inquiry to the entity's legal counsel is the auditor's primary means of obtaining corroboration of the information provided by management concerning material litigation, claims, and assessments. Audit evidence obtained from the entity's in-house general counsel or legal department may provide the auditor with the necessary corroboration. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A51

In certain circumstances, the auditor also may judge it necessary to meet with the entity's legal counsel to discuss the likely outcome of the litigation or claims. This may be the case, for example, when

- the auditor determines that the matter is a significant risk.
- the matter is complex.
- a disagreement exists between management and the entity's external legal counsel.

Ordinarily, such meetings require management's permission and are held with a representative of management in attendance. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A52

An external legal counsel's response to a letter of inquiry and the procedures set forth in [paragraphs .17-.18](#) provide the auditor with sufficient appropriate audit evidence concerning the accounting for, and reporting of, pending and threatened litigation, claims, and assessments. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A53

Audit evidence about the status of litigation, claims, and assessments up to the date of the auditor's report may be obtained by inquiry of management, including in-house legal counsel responsible for dealing with the relevant matters. The auditor may need to obtain updated information from the entity's legal counsel. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A54

In accordance with [section 700](#), *Forming an Opinion and Reporting on Financial Statements*, or [section 703](#), *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, the auditor is required to date the auditor's report no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements.^{fn 13} Accordingly, it is preferable that the entity's legal counsel's response be as close to the date of the auditor's report as is practicable in the circumstances. Specifying the effective date of the entity's legal counsel's response to reasonably approximate the expected date of the auditor's report may obviate the need to obtain updated information from the entity's legal counsel. [As amended, effective for audits of financial statements for periods ending on or after

December 15, 2021, by SAS No. 136. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A55

Clearly specifying the earliest acceptable effective date of the response and the latest date by which it is to be sent to the auditor and informing the entity's legal counsel of these dates timely facilitates the entity's legal counsel's ability to respond timely and adequately. A two-week period between the specified effective date of the entity's legal counsel's response and the latest date by which the response is to be sent to the auditor is generally sufficient. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A56

In some circumstances, the legal counsel may be required by relevant ethical requirements to resign the engagement if the legal counsel's advice concerning financial accounting and reporting for litigation, claims, and assessments is disregarded by the entity. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A57

The legal counsel appropriately may limit the response to matters to which the legal counsel has given substantive attention in the form of legal consultation or representation. Also, the legal counsel's response may be limited to matters that are considered individually or collectively material to the financial statements, such as when the entity and auditor have reached an understanding on the limits of materiality for this purpose and management has communicated such understanding to the legal counsel. Such limitations are not limitations on the scope of the audit. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A58

The legal counsel may be unable to respond concerning the likelihood of an unfavorable outcome of litigation, claims, and assessments or the amount or range of potential loss because of inherent uncertainties. Factors influencing the likelihood of an unfavorable outcome sometimes may not be within the legal counsel's competence to judge; historical experience of the entity in similar litigation or the experience of other entities may not be relevant or available, and the amount of the possible loss frequently may vary widely at different stages of litigation. Consequently, the legal counsel may not be able to form a conclusion with respect to such matters. In such circumstances, the auditor may conclude that the financial statements are affected by an uncertainty concerning the outcome of a future event that cannot be reasonably estimated. If the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement, [section 705](#) requires the auditor to modify the opinion in addressing the effect, if any, of the legal counsel's response on the auditor's report as a result of the scope limitation. [fn 14](#)
[Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A59

An external legal counsel's refusal to furnish the information requested in an inquiry letter either in writing or orally may cause a scope limitation of the audit sufficient to preclude an unmodified opinion. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A60

Although the auditor would consider the inability to review information that could have a significant bearing on the audit as a scope limitation, in recognition of the public interest in protecting the confidentiality of lawyer-client communications, such inability is not intended to require an auditor to

examine documents that the client identifies as subject to the lawyer-client privilege. In the event of questions concerning the applicability of this privilege, the auditor may request confirmation from the entity's legal counsel that the information is subject to that privilege and that the information was considered by the legal counsel in responding to the letter of inquiry or, if the matters are being handled by another legal counsel, an identification of such legal counsel for the purpose of sending a letter of inquiry. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A61

If management imposes a limitation on the scope of the audit and the auditor is unable to obtain sufficient appropriate audit evidence by performing alternative audit procedures, the auditor is required by [section 705](#) to either disclaim an opinion on the financial statements or, when practicable, withdraw from the audit.^{fn.15} [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A62

In some cases, in order to emphasize the preservation of the attorney-client privilege or the attorney work-product privilege, some entities may include the following or substantially similar language in the audit inquiry letter to legal counsel:

We do not intend that either our request to you to provide information to our auditor or your response to our auditor should be construed in any way to constitute a waiver of the attorney-client privilege or the attorney work-product privilege.

For the same reason, some legal counsel may include the following or substantially similar language in their response letters to auditors:

The Company [*or other defined term*] has advised us that, by making the request set forth in its letter to us, the Company [*or other defined term*] does not intend to waive the attorney-client privilege with respect to any information which the Company [*or other defined term*] has furnished to us. Moreover, please be advised that our response to you should not be construed in any way to constitute a waiver of the protection of the attorney work-product privilege with respect to any of our files involving the Company [*or other defined term*].

Explanatory language similar to the foregoing in the letters of the entity or legal counsel is not a limitation on the scope of the legal counsel's response. See [exhibit B](#), "Report of the Subcommittee on Audit Inquiry Responses." [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A63

In order to emphasize the preservation of the attorney-client privilege with respect to unasserted possible claims or assessments, some legal counsel may include the following or substantially similar language in their responses to audit inquiry letters:

Please be advised that pursuant to [clauses \(b\) and \(c\)](#) of Paragraph 5 of the ABA Statement of Policy [*American Bar Association's Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information*] and related [Commentary](#) referred to in the last paragraph of this letter, it would be inappropriate for this firm to respond to a general inquiry relating to the existence of unasserted possible claims or assessments involving the Company. We can only furnish information concerning those unasserted possible claims or assessments upon which the Company has specifically requested in writing that we comment. We also cannot comment upon the adequacy of the Company's listing, if any, of unasserted possible claims or assessments or its assertions concerning the advice, if any, about the need to disclose same.

Additional language similar to the foregoing in a letter from legal counsel is not a limitation on the scope of the audit. However, the ABA statement and the understanding between the legal and accounting professions assumes that the legal counsel, under certain circumstances, will advise and

consult with the entity concerning the entity's obligation to make financial statement disclosure with respect to unasserted possible claims or assessments. Confirmation of this understanding is included in the legal counsel's response. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A64

If the auditor believes that there may be actual or potential material litigation, claims, or assessments and the entity has not engaged external legal counsel relating to such matters, the auditor may discuss with the client the possible need to consult legal counsel to assist the client in determining the appropriate measurement, recognition, or disclosure of related liabilities or loss contingencies in the financial statements, in accordance with the applicable financial reporting framework. Depending on the significance of the matter(s), refusal by management to consult legal counsel in these circumstances may result in a scope limitation of the audit sufficient to preclude an unmodified opinion. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Direct Communication With the Entity's In-House Legal Counsel

.A65

In-house legal counsel can range from one lawyer to a large staff, with responsibilities ranging from specific internal matters to a comprehensive coverage of all of the entity's legal needs, including litigation with outside parties. Because both in-house and external legal counsel are bound by an applicable code of ethics, there should be no significant difference in their professional obligations and responsibilities. In some circumstances, external legal counsel, if used at all, may be used only for limited purposes, such as data accumulation or account collection activity. In such circumstances, in-house legal counsel may have the primary responsibility for corporate legal matters and may be in the best position to know and precisely describe the status of all litigation, claims, and assessments or to corroborate information provided by management. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Evaluation of the Outcome of Litigation, Claims, or Assessment (Ref: [par. .23d\(ii\)](#))

.A66

Although [paragraph 5](#) of the ABA statement states that the legal counsel "may in appropriate circumstances communicate to the auditor his view that an unfavorable outcome is 'probable' or 'remote,'" the legal counsel is not required to use those terms in communicating the evaluation to the auditor. The auditor may find other wording sufficiently clear, as long as the terms can be used to classify the outcome of the uncertainty under one of the three probability classifications established in FASB ASC 450. Some examples of evaluations concerning litigation that may be considered to provide sufficient clarity that the likelihood of an unfavorable outcome is remote, even though they do not use that term, are the following:

- "We are of the opinion that this action will not result in any liability to the company."
- "It is our opinion that the possible liability to the company in this proceeding is nominal in amount."
- "We believe the company will be able to defend this action successfully."
- "We believe that the plaintiff's case against the company is without merit."
- "Based on the facts known to us, after a full investigation, it is our opinion that no liability will be established against the company in these suits."

Absent any contradictory information obtained by the auditor either in other parts of the legal counsel's letter or otherwise, the auditor need not obtain further clarification of evaluations such as the foregoing. Because of inherent uncertainties described in [paragraph .A58](#) and the ABA statement, an evaluation furnished by the legal counsel may indicate significant uncertainties or stipulations about whether the client will prevail. The following are examples of the legal counsel's evaluations that are unclear about the likelihood of an unfavorable outcome:

- "This action involves unique characteristics wherein authoritative legal precedents do not seem to exist. We believe that the plaintiff will have serious problems establishing

the company's liability under the act; nevertheless, if the plaintiff is successful, the award may be substantial."

- "It is our opinion that the company will be able to assert meritorious defenses to this action." (The term *meritorious defenses* indicates that the entity's defenses will not be summarily dismissed by the court; it does not necessarily indicate the legal counsel's opinion that the entity will prevail.)
- "We believe the action can be settled for less than the damages claimed."
- "We are unable to express an opinion as to the merits of the litigation at this time. The company believes there is absolutely no merit to the litigation." (If the entity's legal counsel, with the benefit of all relevant information, is unable to conclude that the likelihood of an unfavorable outcome is remote, it is unlikely that management would be able to form a judgment to that effect.)
- "In our opinion, the company has a substantial chance of prevailing in this action." (A *substantial chance*, a *reasonable opportunity*, and similar terms indicate more uncertainty than an opinion that the company will prevail.)

If the auditor is uncertain about the meaning of the legal counsel's evaluation, clarification either in a follow-up letter or conference with the legal counsel and entity, appropriately documented, may be appropriate. If the legal counsel is still unable to give an unequivocal evaluation of the likelihood of an unfavorable outcome in writing or orally, the auditor is required by [section 700](#), or [section 703](#), to determine the effect, if any, of the legal counsel's response on the auditor's report. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Segment Information (Ref: [par. .26](#))

.A67

Depending on the applicable financial reporting framework, the entity may be required or permitted to disclose segment information in the financial statements. The auditor's responsibility regarding the presentation and disclosure of segment information is in relation to the financial statements as a whole. Accordingly, the auditor is not required to perform audit procedures that would be necessary to express an opinion on the segment information presented on a stand-alone basis. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Considerations Specific to Governmental Entities

.A68

For governmental entities required by the applicable financial reporting framework to disclose segment information, the auditor's responsibility regarding the presentation and disclosure of segment information is in relation to the financial statements of the opinion unit(s) on which the segment information is based.^{[fn 16](#)} [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Understanding of the Methods Used by Management (Ref: [par. .26a](#))

.A69

Depending on the circumstances, examples of matters that may be relevant when obtaining an understanding of the methods used by management in determining segment information and evaluating whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework include the following:

- Sales, transfers, and charges between segments and elimination of intersegment amounts
- Comparisons with budgets and other expected results (for example, operating profits as a percentage of sales)
- The allocation of assets and costs among segments
- Consistency with prior periods and the adequacy of the disclosures with respect to inconsistencies

- Management’s process for identifying those segments that require disclosure in accordance with the entity’s financial reporting framework

[Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Using the Work of a Management’s Specialist (Ref: [par. .27](#))

.A70

The preparation of an entity’s financial statements may require expertise in a field other than accounting or auditing, such as actuarial calculations, valuations, or engineering data. The entity uses a management’s specialist in these fields to obtain the needed expertise to prepare the financial statements. Failure to do so when such expertise is necessary increases the risks of material misstatement and may be a significant deficiency or material weakness.^{fn 17} [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A71

When information to be used as audit evidence has been prepared using the work of a management’s specialist, the requirement in [paragraph .27](#) applies. For example, an individual or organization may possess expertise in the application of models to estimate the fair value of securities for which no observable market exists. If the individual or organization applies that expertise in making an estimate, which the entity uses in preparing its financial statements, the individual or organization is a management’s specialist, and [paragraph .27](#) applies. If, on the other hand, that individual or organization merely provides price data regarding private transactions not otherwise available to the entity, which the entity uses in its own estimation methods, such information, if used as audit evidence, is subject to the evaluation required by [section 500](#),^{fn 18} but it is not the use of a management’s specialist by the entity. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A72

The nature, timing, and extent of audit procedures with regard to the requirement in [paragraph .27](#) may be affected by matters such as the following:

- The nature and complexity of the matter to which the management’s specialist relates
- The risks of material misstatement of the matter
- The availability of alternative sources of audit evidence
- The nature, scope, and objectives of the work of the management’s specialist
- Whether the management’s specialist is employed by the entity or is a party engaged by it to provide relevant services
- The extent to which management can exercise control or influence over the management’s specialist (including, when applicable, the organization that employs the individual specialist), thereby influencing the work of the management’s specialist
- Whether the management’s specialist is subject to technical performance standards or other professional or industry requirements
- The nature and extent of any controls within the entity over the work of the management’s specialist
- The auditor’s knowledge and experience of the field of expertise of management’s specialist
- The auditor’s previous experience of the work of that specialist

More persuasive audit evidence is needed with regard to the requirement in [paragraph .27](#) as the significance of the management’s specialist’s work, the risk of material misstatement at the relevant assertion level, or the ability of management to affect the specialist’s judgments increases, or as the competence, capabilities, and objectivity possessed by the specialist in the particular field decreases.

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

The Competence, Capabilities, and Objectivity of a Management's Specialist (Ref: [par. .27a](#))

.A73

Competence relates to the nature and level of expertise of the management's specialist. Capability relates to the ability of the management's specialist to exercise that competence in the circumstances. Factors that influence capability may include, for example, geographic location and the availability of time and resources. Objectivity relates to the possible effects that bias, conflict of interest, or the influence of others may have on the professional or business judgment of the management's specialist. The competence, capabilities, and objectivity of a management's specialist, and any controls within the entity over that specialist's work, are important factors with regard to the reliability of any information produced by a management's specialist. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A74

Information regarding the competence, capabilities, and objectivity of a management's specialist may come from a variety of sources, such as the following:

- Personal experience with previous work of that specialist
- Discussions with that specialist
- Discussions with others who are familiar with that specialist's work
- Knowledge of that specialist's qualifications, membership in a professional body or industry association, license to practice, or other forms of external recognition
- Published papers or books written by that specialist
- An auditor's specialist, if any, that assists the auditor in obtaining sufficient appropriate audit evidence with respect to information produced by the management's specialist

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A75

Matters relevant to evaluating the competence, capabilities, and objectivity of a management's specialist include whether that specialist's work is subject to technical performance standards or other professional or industry requirements, for example, ethical standards and other membership requirements of a professional body or industry association, accreditation standards of a licensing body, or requirements imposed by law or regulation. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A76

Other matters that may be relevant include the following:

- The relevance of the capabilities and competence of the management's specialist to the matter for which that specialist's work will be used, including any areas of specialty within that specialist's field. For example, a particular actuary may specialize in property and casualty insurance but have limited expertise regarding pension calculations
- The competence of the management's specialist with respect to relevant accounting requirements, for example, knowledge of assumptions and methods, including models, when applicable, that are consistent with the applicable financial reporting framework

- Whether unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures indicate that it may be necessary to reconsider the initial evaluation of the competence, capabilities, and objectivity of the management's specialist as the audit progresses

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A77

A broad range of circumstances may threaten objectivity, for example, self-interest threats, advocacy threats, familiarity threats, self-review threats, and intimidation threats. Safeguards may reduce such threats and may be created either by external structures (for example, the profession, legislation, or regulation of the management's specialist) or by the work of the management's specialist's environment (for example, quality control policies and procedures). [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A78

Although safeguards cannot eliminate all threats to the objectivity of a management's specialist, threats such as intimidation threats may be of less significance to a specialist engaged by the entity than to a specialist employed by the entity, and the effectiveness of safeguards such as quality control policies and procedures may be greater. Because the threat to objectivity created by being an employee of the entity will always be present, a specialist employed by the entity cannot ordinarily be regarded as being more likely to be objective than other employees of the entity. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A79

When evaluating the objectivity of a specialist engaged by the entity, it may be relevant to discuss with management and that specialist any interests and relationships that may create threats to the specialist's objectivity and any applicable safeguards, including any professional requirements that apply to the specialist, and to evaluate whether the safeguards are adequate. Relevant information may be obtained by the auditor from procedures performed in accordance with [section 550, *Related Parties*](#). Interests and relationships creating threats may include the following:

- Financial interests
- Business and personal relationships between the entity and the individual specialist and between the entity and the organization that employs the individual specialist
- Provision of other services

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

Obtaining an Understanding of the Work of the Management's Specialist

(Ref: [par. .27b](#))

.A80

An understanding of the work of the management's specialist includes an understanding of the relevant field of expertise. An understanding of the relevant field of expertise may be obtained in conjunction with the auditor's determination of whether the auditor has the expertise to evaluate the work of the management's specialist or whether the auditor needs an auditor's specialist for this purpose.^{fn 19} [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A81

Aspects of the field of the management's specialist relevant to the auditor's understanding may include

- whether that specialist's field has areas of specialty within it that are relevant to the audit.
- whether any professional or other standards and regulatory or legal requirements apply.
- what assumptions and methods are used by the management's specialist and whether they are generally accepted within that specialist's field appropriately applied under the applicable financial reporting framework.
- the nature of internal and external data or information the management's specialist uses.

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A82

In the case of a management's specialist engaged by the entity, there will ordinarily be an engagement letter or other written form of agreement between the entity and that specialist. Evaluating that agreement when obtaining an understanding of the work of the management's specialist may assist the auditor in determining for the auditor's purposes the appropriateness of

- the nature, scope, and objectives of that specialist's work;
- the respective roles and responsibilities of management and that specialist; and
- the nature, timing, and extent of communication between management and that specialist, including the form of any report to be provided by that specialist.

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A83

In the case of a management's specialist employed by the entity, it is less likely that there will be a written agreement of this kind. Inquiry of the specialist and other members of management may be the most appropriate way for the auditor to obtain the necessary understanding. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Evaluating the Appropriateness of the Work of the Management's Specialist **(Ref: [par. .27c](#))**

.A84

[Section 540](#) includes requirements and guidance related to accounting estimates, including the selection and application of the methods, significant assumptions, and data used in making the accounting estimate. [fn.20](#) Considerations when evaluating the appropriateness of the work of the management's specialist as audit evidence for the relevant assertion may include

- if that specialist's work involves significant assumptions, the appropriateness of the assumptions, taking into account the consistency of those assumptions with relevant information
- if that specialist's work involves the use of methods, the appropriateness of the methods under the circumstances, taking into account the requirements of the applicable financial reporting framework;
- if that specialist's work involves significant use of source data, including entity-produced data, the relevance and reliability of that source data; and

- the relevance and reasonableness of that specialist's findings or conclusions, the consistency of the findings or conclusions with other audit evidence, and whether the findings or conclusions have been appropriately reflected in the financial statements.

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A85

If the work of the management's specialist involves use of significant assumptions developed by the management's specialist, evaluating the appropriateness of those assumptions may include taking into account the consistency of those assumptions with relevant information such as the following:

- Assumptions generally accepted within the specialist's field
- Supporting information provided by the specialist
- Industry, regulatory, and other external factors, including economic conditions
- The entity's objectives, strategies, and related business risks
- Existing market information
- Historical or recent experience, along with changes in conditions and events affecting the entity
- Significant assumptions used in other estimates tested in the entity's financial statements

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A86

If the methods of the management's specialist include the use of a proprietary model, the auditor's procedures may include, for example

- obtaining an understanding of the model through
- inquiry of the specialist, and
- reading descriptions of the model in the specialist's report or equivalent communication;
- testing controls over the entity's evaluation of the specialist's work;
- testing mathematical accuracy of the calculations under the model, if practicable; or
- assessing the inputs to and output from the model, which may involve using an alternative model for comparison.

The extent of such procedures will depend on the type of model used (for example, commercially available versus internally developed) and the applicability of the factors described in [paragraph .A71](#). [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A87

Factors that affect the relevance and reliability of the work of the management's specialist include the following:

- The results of the auditor's procedures over internal or external data, significant assumptions, and methods
- The nature of any restrictions, disclaimers, or limitations in the specialist's report or equivalent communication
- The consistency of the management's specialist's work with other evidence obtained by the auditor and the auditor's understanding of the entity and its environment

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A88

Additional procedures may be necessary if the management's specialist's findings or conclusions appear to contradict the relevant assertion, or the management's specialist's work does not provide sufficient appropriate audit evidence. Examples of situations in which additional procedures may be necessary include the following:

- The findings and conclusions of the management's specialist are inconsistent with
- other information, if any, in the specialist's report, or equivalent communication,
- other evidence obtained by the auditor, or
- the auditor's understanding of the entity and its environment.
- The management's specialist's report, or equivalent communication, contains restrictions, disclaimers, or limitations regarding the auditor's use of the report or communication.
- The auditor has identified exceptions in performing procedures related to data, significant assumptions, or methods.
- The auditor has doubts about the competence, capabilities, or objectivity of the management's specialist.
- The management's specialist has a conflict of interest relevant to the specialist's work.

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

Appendix — Illustrative Audit Inquiry Letter to Legal Counsel (Ref: [par. .23](#))

.A89

In connection with an audit of our financial statements at (balance sheet date) and for the (period) then ended, management of the Company has prepared, and furnished to our auditors (name and address of auditors), a description and evaluation of certain contingencies, including those set forth below involving matters with respect to which you have been engaged and to which you have devoted substantive attention on behalf of the Company in the form of legal consultation or representation. These contingencies are regarded by management of the Company as material for this purpose (management may indicate a materiality limit if an understanding has been reached with the auditor). Your response should include matters that existed at (balance sheet date) and during the period from that date to the date of your response.

[Alternative wording when management requests the lawyer to prepare the list that describes and evaluates pending or threatened litigation, claims, and assessments is as follows:]

In connection with an audit of our financial statements as of (balance-sheet date) and for the (period) then ended, please furnish our auditors, (name and address of auditors), with the information requested below concerning certain contingencies involving matters with respect to which you have devoted substantive attention on behalf of the Company in the form of legal consultation or representation. *[When a materiality limit has been established based on an understanding between management and the auditor, the following sentence should be added: This request is limited to contingencies amounting to (amount) individually or items involving lesser amounts that exceed (amount) in the aggregate.]*

Pending or Threatened Litigation (Excluding Unasserted Claims)

[Ordinarily the information would include the following: (1) the nature of the litigation, (2) the progress of the case to date, (3) how management is responding or intends to respond to the litigation (for example, to contest the case vigorously or to seek an out-of-court settlement), and (4) an evaluation of the likelihood of an unfavorable outcome and an estimate, if one can be made, of the amount or range of potential loss.] This letter will serve as our consent for you to furnish to our auditor all the information requested herein. Accordingly, please furnish to our auditors such explanation, if any, that you consider necessary to supplement the foregoing information, including an explanation of those matters for which your views may differ from those stated and an identification of

the omission of any pending or threatened litigation, claims, and assessments or a statement that the list of such matters is complete.

[Alternative wording when management requests the lawyer to prepare the list that describes and evaluates pending or threatened litigation, claims, and assessments is as follows:]

Regarding pending or threatened litigation, claims, and assessments, please include in your response: (1) the nature of each matter, (2) the progress of each matter to date, (3) how the Company is responding or intends to respond (for example, to contest the case vigorously or seek an out-of-court settlement), and (4) an evaluation of the likelihood of an unfavorable outcome and an estimate, if one can be made, of the amount or range of potential loss.

Unasserted Claims and Assessments (Considered by Management to be Probable of Assertion and That, if Asserted, Would Have at Least a Reasonable Possibility of an Unfavorable Outcome)

[Ordinarily management's information would include the following: (1) the nature of the matter, (2) how management intends to respond if the claim is asserted, and (3) an evaluation of the likelihood of an unfavorable outcome and an estimate, if one can be made, of the amount or range of potential loss.] Please furnish to our auditors such explanation, if any, that you consider necessary to supplement the foregoing information, including an explanation of those matters for which your views may differ from those stated.

We understand that whenever, in the course of performing legal services for us with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, if you have formed a professional conclusion that we should disclose or consider disclosure concerning such possible claim or assessment, as a matter of professional responsibility to us, you will so advise us and will consult with us concerning the question of such disclosure and the applicable requirements of Financial Accounting Standards Board (FASB) *Accounting Standards Codification (ASC) 450, Contingencies*. Please specifically confirm to our auditors that our understanding is correct.

[Alternative wording when management requests the lawyer to prepare the list that describes and evaluates pending or threatened litigation, claims, and assessments is as follows:]

We have represented to our auditors that there are no unasserted possible claims or assessments that you have advised us are probable of assertion and must be disclosed in accordance with FASB ASC 450. We understand that whenever, in the course of performing legal services for us with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, you have formed a professional conclusion that we should disclose or consider disclosure concerning such possible claim or assessment, as a matter of professional responsibility to us, you will so advise us and will consult with us concerning the question of such disclosure and the applicable requirements of FASB ASC 450. Please specifically confirm to our auditors that our understanding is correct.

Please specifically identify the nature of and reasons for any limitation on your response.

[The auditor may request the client to inquire about additional matters, for example, unpaid or unbilled charges or specified information on certain contractually assumed obligations of the Company, such as guarantees of indebtedness of others.]

[Alternative wording when management requests the lawyer to prepare the list that describes and evaluates pending or threatened litigation, claims, and assessments is as follows:]

Your response should include matters that existed as of (balance-sheet date) and during the period from that date to the effective date of your response. Please specifically identify the nature of and reasons for any limitations on your response. Our auditors expect to have the audit completed about (expected completion date). They would appreciate receiving your reply by that date with a specified effective date no earlier than (ordinarily two weeks before expected completion date).

[Wording that could be used in an audit inquiry letter, instead of the heading and first paragraph, when the client believes that there are no unasserted claims or assessments (to be specified to the lawyer for comment) that are probable of assertion and that, if asserted, would have a reasonable possibility of an unfavorable outcome as specified by Financial Accounting Standards Board Accounting Standards Codification 450, Contingencies, is as follows:]

Unasserted claims and assessments — We have represented to our auditors that there are no unasserted possible claims that you have advised us are probable of assertion and must be disclosed, in accordance with Financial Accounting Standards Board *Accounting Standards Codification* 450, *Contingencies*. (The second paragraph in the section relating to unasserted claims and assessments would not be altered.)

[Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 143, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 144, July 2021.]

Exhibit A — American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information (Ref: [par. .A49](#))

.A90

Note: This document, in the form herein set forth, was approved by the Board of Governors of the American Bar Association (ABA) in December 1975, which official action permitted its release to lawyers and accountants as the standard recommended by the ABA for the lawyer's response to letters of audit inquiry.

Source: Statement on Auditing Standards No. 12 section 337C, *Exhibit II—American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information*^{fn*}

Preamble

The public interest in protecting the confidentiality of lawyer-client communications is fundamental. The American legal, political and economic systems depend heavily upon voluntary compliance with the law and upon ready access to a respected body of professionals able to interpret and advise on the law. The expanding complexity of our laws and governmental regulations increases the need for prompt, specific and unhampered lawyer-client communication. The benefits of such communication and early consultation underlie the strict statutory and ethical obligations of the lawyer to preserve the confidences and secrets of the client, as well as the long-recognized testimonial privilege for lawyer-client communication.

Both the Code of Professional Responsibility and the cases applying the evidentiary privilege recognize that the privilege against disclosure can be knowingly and voluntarily waived by the client. It is equally clear that disclosure to a third party may result in loss of the "confidentiality" essential to maintain the privilege. Disclosure to a third party of the lawyer-client communication on a particular subject may also destroy the privilege as to other communications on that subject. Thus, the mere disclosure by the lawyer to the outside auditor, with due client consent, of the substance of communications between the lawyer and client may significantly impair the client's ability in other contexts to maintain the confidentiality of such communications.

Under the circumstances a policy of audit procedure which requires clients to give consent and authorize lawyers to respond to general inquiries and disclose information to auditors concerning matters which have been communicated in confidence is essentially destructive of free and open communication and early consultation between lawyer and client. The institution of such a policy would inevitably discourage management from discussing potential legal problems with counsel for fear that such discussion might become public and precipitate a loss to or possible liability of the business enterprise and its stockholders that might otherwise never materialize.

It is also recognized that our legal, political and economic systems depend to an important extent on public confidence in published financial statements. To meet this need the accounting profession must adopt and adhere to standards and procedures that will command confidence in the auditing process. It is not, however, believed necessary, or sound public policy, to intrude upon the confidentiality of the lawyer-client relationship in order to command such confidence. On the contrary, the objective of fair disclosure in financial statements is more likely to be better served by maintaining the integrity of the confidential relationship between lawyer and client, thereby strengthening corporate management's confidence in counsel and encouraging its readiness to seek advice of counsel and to act in accordance with counsel's advice.

Consistent with the foregoing public policy considerations, it is believed appropriate to distinguish between, on the one hand, litigation which is pending or which a third party has manifested to the client a present intention to commence and, on the other hand, other contingencies of a legal nature or having legal aspects. As regards the former category, unquestionably the lawyer representing the client in a litigation matter may be the best source for a description of the claim or claims asserted, the client's position (e.g., denial, contest, etc.), and the client's possible exposure in the litigation (to the extent the lawyer is in a position to do so). As to the latter category, it is submitted that, for the reasons set forth above, it is not in the public interest for the lawyer to be required to respond to general inquiries from auditors concerning possible claims.

It is recognized that the disclosure requirements for enterprises subject to the reporting requirements of the Federal securities laws are a major concern of managements and counsel, as well as auditors. It is submitted that compliance therewith is best assured when clients are afforded maximum encouragement, by protecting lawyer-client confidentiality, freely to consult counsel. Likewise, lawyers must be keenly conscious of the importance of their clients being competently advised in these matters.

Statement of Policy

NOW, THEREFORE, BE IT RESOLVED that it is desirable and in the public interest that this Association adopt the following Statement of Policy regarding the appropriate scope of the lawyer's response to the auditor's request, made by the client at the request of the auditor, for information concerning matters referred to the lawyer during the course of his representation of the client:

1. *Client Consent to Response.* The lawyer may properly respond to the auditor's requests for information concerning loss contingencies (the term and concept established by Statement of Financial Accounting Standards No. 5,^{fn.1} promulgated by the Financial Accounting Standards Board in March 1975 and discussed in [Paragraph 5.1](#) of the accompanying Commentary), to the extent hereinafter set forth, subject to the following:

a. Assuming that the client's initial letter requesting the lawyer to provide information to the auditor is signed by an agent of the client having apparent authority to make such a request, the lawyer may provide to the auditor information requested, without further consent, unless such information discloses a confidence or a secret or requires an evaluation of a claim.

b. In the normal case, the initial request letter does not provide the necessary consent to the disclosure of a confidence or secret or to the evaluation of a claim since that consent may only be given after full disclosure to the client of the legal consequences of such action.

c. Lawyers should bear in mind, in evaluating claims, that an adverse party may assert that any evaluation of potential liability is an admission.

d. In securing the client's consent to the disclosure of confidences or secrets, or the evaluation of claims, the lawyer may wish to have a draft of his letter reviewed and approved by the client before releasing it to the auditor; in such cases, additional explanation would in all probability be necessary so that the legal consequences of the consent are fully disclosed to the client.

2. *Limitation on Scope of Response.* It is appropriate for the lawyer to set forth in his response, by way of limitation, the scope of his engagement by the client. It is also appropriate for the lawyer to indicate the date as of which information is furnished and to disclaim any undertaking to advise the auditor of changes which may thereafter be brought to the lawyer's attention. *Unless the lawyer's response indicates otherwise, (a) it is properly limited to matters which have been given substantive attention by the lawyer in the form of legal consultation and, where appropriate, legal representation since the beginning of the period or periods being reported upon, and (b) if a law firm or a law department, the auditor may assume that the firm or department has endeavored, to the extent believed necessary by the firm or department, to determine from lawyers currently in the firm or department who have performed services for the client since the beginning of the fiscal period under audit whether such services involved substantive attention in the form of legal consultation concerning those loss contingencies referred to in [Paragraph 5\(a\)](#) below but, beyond that, no review has been made of any of the client's transactions or other matters for the purpose of identifying loss contingencies to be described in the response.*^{fn±}

3. *Response may be Limited to Material Items.* In response to an auditor's request for disclosure of loss contingencies of a client, it is appropriate for the lawyer's response to indicate that the response is limited to items which are considered individually or collectively material to the presentation of the client's financial statements.

4. *Limited Responses.* Where the lawyer is limiting his response in accordance with the Statement of Policy, his response should so indicate (see [Paragraph 8](#)). If in any other respect the lawyer is not undertaking to respond to or comment on particular aspects of the inquiry when responding to the auditor, he should consider advising the auditor that his response is limited, in order to avoid any inference that the lawyer has responded to all aspects; otherwise, he may be assuming a responsibility which he does not intend.

5. *Loss Contingencies.* When properly requested by the client, it is appropriate for the lawyer to furnish to the auditor information concerning the following matters if the lawyer has been engaged by the client to represent or advise the client professionally with respect thereto and he has devoted substantive attention to them in the form of legal representation or consultation:

a. *overtly threatened or pending litigation*, whether or not specified by the client;

b. *a contractually assumed obligation* which the client has specifically identified and upon which the client has specifically requested, in the inquiry letter or a supplement thereto, comment to the auditor;

c. *an unasserted possible claim or assessment* which the client has specifically identified and upon which the client has specifically requested, in the inquiry letter or a supplement thereto, comment to the auditor.

With respect to [clause \(a\)](#), overtly threatened litigation means that a potential claimant has manifested to the client an awareness of and present intention to assert a possible claim or assessment unless the likelihood of litigation (or of settlement when litigation would normally be avoided) is considered remote. With respect to [clause \(c\)](#), where there has been no manifestation by a potential claimant of an awareness of and present intention to assert a possible claim or assessment, consistent with the considerations and concerns outlined in the [Preamble](#) and [Paragraph 1](#) hereof, the client should request the lawyer to furnish information to the auditor only if the client has determined that it is probable that a possible claim will be asserted, that there is a reasonable possibility that the outcome (assuming such assertion) will be unfavorable, and that the resulting liability would be material to the financial condition of the client. Examples of such situations might (depending in each case upon the particular circumstances) include the following: (i) a catastrophe, accident or other similar physical occurrence in which the client's involvement is open and notorious, or (ii) an investigation by a government agency where enforcement proceedings have been instituted or where the likelihood that they will not be instituted is remote, under circumstances where assertion of one or more private claims for redress would normally be expected, or (iii) a public disclosure by the client acknowledging (and thus focusing attention upon) the existence of one or more probable claims

arising out of an event or circumstance. In assessing whether or not the assertion of a possible claim is probable, it is expected that the client would normally employ, by reason of the inherent uncertainties involved and insufficiency of available data, concepts parallel to those used by the lawyer (discussed below) in assessing whether or not an unfavorable outcome is probable; thus, assertion of a possible claim would be considered probable only when the prospects of its being asserted seem reasonably certain (i.e., supported by extrinsic evidence strong enough to establish a presumption that it will happen) and the prospects of nonassertion seem slight.

It would not be appropriate, however, for the lawyer to be requested to furnish information in response to an inquiry letter or supplement thereto if it appears that (a) the client has been required to specify unasserted possible claims without regard to the standard suggested in the preceding paragraph, or (b) the client has been required to specify all or substantially all unasserted possible claims as to which legal advice may have been obtained, since, in either case, such a request would be in substance a general inquiry and would be inconsistent with the intent of this Statement of Policy.

The information that lawyers may properly give to the auditor concerning the foregoing matters would include (to the extent appropriate) an identification of the proceedings or matter, the stage of proceedings, the claim(s) asserted, and the position taken by the client.

In view of the inherent uncertainties, the lawyer should normally refrain from expressing judgments as to outcome except in those relatively few clear cases where it appears to the lawyer that an unfavorable outcome is either "probable" or "remote"; for purposes of any such judgment it is appropriate to use the following meanings:

i. probable — an unfavorable outcome for the client is probable if the prospects of the claimant not succeeding are judged to be extremely doubtful and the prospects for success by the client in its defense are judged to be slight.

ii. remote — an unfavorable outcome is remote if the prospects for the client not succeeding in its defense are judged to be extremely doubtful and the prospects of success by the claimant are judged to be slight.

If, in the opinion of the lawyer, considerations within the province of his professional judgment bear on a particular loss contingency to the degree necessary to make an informed judgment, he may in appropriate circumstances communicate to the auditor his view that an unfavorable outcome is "probable" or "remote," applying the above meanings. No inference should be drawn, from the absence of such a judgment, that the client will not prevail.

The lawyer also may be asked to estimate, in dollar terms, the potential amount of loss or range of loss in the event that an unfavorable outcome is not viewed to be "remote." In such a case, the amount or range of potential loss will normally be as inherently impossible to ascertain, with any degree of certainty, as the outcome of the litigation. Therefore, it is appropriate for the lawyer to provide an estimate of the amount or range of potential loss (if the outcome should be unfavorable) only if he believes that the probability of inaccuracy of the estimate of the amount or range of potential loss is slight.

The considerations bearing upon the difficulty in estimating loss (or range of loss) where pending litigation is concerned are obviously even more compelling in the case of unasserted possible claims. In most cases, the lawyer will not be able to provide any such estimate to the auditor.

As indicated in [Paragraph 4](#) hereof, the auditor may assume that all loss contingencies specified by the client in the manner specified in [clauses \(b\) and \(c\)](#) above have received comment in the response, unless otherwise therein indicated. The lawyer should not be asked, nor need the lawyer undertake, to furnish information to the auditor concerning loss contingencies except as contemplated by this [Paragraph 5](#).

6. Lawyer's Professional Responsibility. Independent of the scope of his response to the auditor's request for information, the lawyer, depending upon the nature of the matters as to which he is

engaged, may have as part of his professional responsibility to his client an obligation to advise the client concerning the need for or advisability of public disclosure of a wide range of events and circumstances. The lawyer has an obligation not knowingly to participate in any violation by the client of the disclosure requirements of the securities laws. In appropriate circumstances, the lawyer also may be required under the Code of Professional Responsibility to resign his engagement if his advice concerning disclosures is disregarded by the client. The auditor may properly assume that whenever, in the course of performing legal services for the client with respect to a matter recognized to involve an unasserted possible claim or assessment which may call for financial statement disclosure, the lawyer has formed a professional conclusion that the client must disclose or consider disclosure concerning such possible claim or assessment, the lawyer, as a matter of professional responsibility to the client, will so advise the client and will consult with the client concerning the question of such disclosure and the applicable requirements^{fn 11} of FAS 5.

7. Limitation on Use of Response. Unless otherwise stated in the lawyer's response, it shall be solely for the auditor's information in connection with his audit of the financial condition of the client and is not to be quoted in whole or in part or otherwise referred to in any financial statements of the client or related documents, nor is it to be filed with any governmental agency or other person, without the lawyer's prior written consent.^{fn 12} Notwithstanding such limitation, the response can properly be furnished to others in compliance with court process or when necessary in order to defend the auditor against a challenge of the audit by the client or a regulatory agency, provided that the lawyer is given written notice of the circumstances at least twenty days before the response is so to be furnished to others, or as long in advance as possible if the situation does not permit such period of notice.^{fn 13}

8. General. This Statement of Policy, together with the accompanying [Commentary](#) (which is an integral part hereof), has been developed for the general guidance of the legal profession. In a particular case, the lawyer may elect to supplement or modify the approach hereby set forth. If desired, this Statement of Policy may be incorporated by reference in the lawyer's response by the following statement: "This response is limited by, and in accordance with, the ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information (December 1975); without limiting the generality of the foregoing, the limitations set forth in such Statement on the scope and use of this response ([Paragraphs 2](#) and [7](#)) are specifically incorporated herein by reference, and any description herein of any 'loss contingencies' is qualified in its entirety by [Paragraph 5](#) of the Statement and the accompanying [Commentary](#) (which is an integral part of the Statement)."

The accompanying [Commentary](#) is an integral part of this Statement of Policy.

Commentary

Paragraph 1 (Client Consent to Response)

In responding to any aspect of an auditor's inquiry letter, the lawyer must be guided by his ethical obligations as set forth in the Code of Professional Responsibility. Under Canon 4 of the Code of Professional Responsibility a lawyer is enjoined to preserve the client's confidences (defined as information protected by the attorney-client privilege under applicable law) and the client's secrets (defined as other information gained in the professional relationship that the client has requested be held inviolate or the disclosure of which would be embarrassing or would be likely to be detrimental to the client). The observance of this ethical obligation, in the context of public policy, "... not only facilitates the full development of facts essential to proper representation of the client but also encourages laymen to seek early legal assistance." (Ethical Consideration 4-1).

The lawyer's ethical obligation therefore includes a much broader range of information than that protected by the attorney-client privilege. As stated in Ethical Consideration 4-4: "The attorney-client privilege is more limited than the ethical obligation of a lawyer to guard the confidences and secrets of his client. This ethical precept, unlike the evidentiary privilege, exists without regard to the nature or source of information or the fact that others share the knowledge."

In recognition of this ethical obligation, the lawyer should be careful to disclose fully to his client any confidence, secret or evaluation that is to be revealed to another, including the client's auditor, and to

satisfy himself that the officer or agent of a corporate client consenting to the disclosure understands the legal consequences thereof and has authority to provide the required consent.

The law in the area of attorney-client privilege and the impact of statements made in letters to auditors upon that privilege has not yet been developed. Based upon cases treating the attorney-client privilege in other contexts, however, certain generalizations can be made with respect to the possible impact of statements in letters to auditors.

It is now generally accepted that a corporation may claim the attorney-client privilege. Whether the privilege extends beyond the control group of the corporation (a concept found in the existing decisional authority), and if so, how far, is yet unresolved.

If a client discloses to a third party a part of any privileged communication he has made to his attorney, there may have been a waiver as to the whole communication; further, it has been suggested that giving accountants access to privileged statements made to attorneys may waive any privilege as to those statements. Any disclosure of privileged communications relating to a particular subject matter may have the effect of waiving the privilege on other communications with respect to the same subject matter.

To the extent that the lawyer's knowledge of unasserted possible claims is obtained by means of confidential communications from the client, any disclosure thereof might constitute a waiver as fully as if the communication related to pending claims.

A further difficulty arises with respect to requests for evaluation of either pending or unasserted possible claims. It might be argued that any evaluation of a claim, to the extent based upon a confidential communication with the client, waives any privilege with respect to that claim.

Another danger inherent in a lawyer's placing a value on a claim, or estimating the likely result, is that such a statement might be treated as an admission or might be otherwise prejudicial to the client.

The Statement of Policy has been prepared in the expectation that judicial development of the law in the foregoing areas will be such that useful communication between lawyers and auditors in the manner envisaged in the Statement will not prove prejudicial to clients engaged in or threatened with adversary proceedings. If developments occur contrary to this expectation, appropriate review and revision of the Statement of Policy may be necessary.

Paragraph 2 (Limitation on Scope of Response)

In furnishing information to an auditor, the lawyer can properly limit himself to loss contingencies which he is handling on a substantive basis for the client in the form of legal consultation (advice and other attention to matters not in litigation by the lawyer in his professional capacity) or legal representation (counsel of record or other direct professional responsibility for a matter in litigation). Some auditors' inquiries go further and ask for information on matters of which the lawyer "has knowledge." Lawyers are concerned that such a broad request may be deemed to include information coming from a variety of sources including social contact and third party contacts as well as professional engagement and that the lawyer might be criticized or subjected to liability if some of this information is forgotten at the time of the auditor's request.

It is also believed appropriate to recognize that the lawyer will not necessarily have been authorized to investigate, or have investigated, all legal problems of the client, even when on notice of some facts which might conceivably constitute a legal problem upon exploration and development. Thus, consideration in the form of preliminary or passing advice, or regarding an incomplete or hypothetical state of facts, or where the lawyer has not been requested to give studied attention to the matter in question, would not come within the concept of "substantive attention" and would therefore be excluded. Similarly excluded are matters which may have been mentioned by the client but which are not actually being handled by the lawyer. [Paragraph 2](#) undertakes to deal with these concerns.

[Paragraph 2](#) is also intended to recognize the principle that the appropriate lawyer to respond as to a particular loss contingency is the lawyer having charge of the matter for the client (e.g., the lawyer representing the client in a litigation matter and/or the lawyer having overall charge and supervision of the matter), and that the lawyer not having that kind of role with respect to the matter should not be expected to respond merely because of having become aware of its existence in a general or incidental way.

The internal procedures to be followed by a law firm or law department may vary based on factors such as the scope of the lawyer's engagement and the complexity and magnitude of the client's affairs. Such procedures could, but need not, include use of a docket system to record litigation, consultation with lawyers in the firm or department having principal responsibility for the client's affairs or other procedures which, in light of the cost to the client, are not disproportionate to the anticipated benefit to be derived. Although these procedures may not necessarily identify all matters relevant to the response, the evolution and application of the lawyer's customary procedures should constitute a reasonable basis for the lawyer's response.

As the lawyer's response is limited to matters involving his professional engagement as counsel, such response should not include information concerning the client which the lawyer receives in another role. In particular, a lawyer who is also a director or officer of the client would not include information which he received as a director or officer unless the information was also received (or, absent the dual role, would in the normal course be received) in his capacity as legal counsel in the context of his professional engagement. Where the auditor's request for information is addressed to a law firm as a firm, the law firm may properly assume that its response is not expected to include any information which may have been communicated to the particular individual by reason of his serving in the capacity of director or officer of the client. The question of the individual's duty, in his role as a director or officer, is not here addressed.

Paragraph 3 (Response May Cover only Material Items in Certain Cases)

[Paragraph 3](#) makes it clear that the lawyer may optionally limit his responses to those items which are individually or collectively material to the auditor's inquiry. If the lawyer takes responsibility for making a determination that a matter is not material for the purposes of his response to the audit inquiry, he should make it clear that his response is so limited. The auditor, in such circumstance, should properly be entitled to rely upon the lawyer's response as providing him with the necessary corroboration. It should be emphasized that the employment of inside general counsel by the client should not detract from the acceptability of his response since inside general counsel is as fully bound by the professional obligations and responsibilities contained in the Code of Professional Responsibility as outside counsel. If the audit inquiry sets forth a definition of materiality but the lawyer utilizes a different test of materiality, he should specifically so state. The lawyer may wish to reach an understanding with the auditor concerning the test of materiality to be used in his response, but he need not do so if he assumes responsibility for the criteria used in making materiality determinations. Any such understanding with the auditor should be referred to or set forth in the lawyer's response. In this connection, it is assumed that the test of materiality so agreed upon would not be so low in amount as to result in a disservice to the client and an unreasonable burden on counsel.

Paragraph 4 (Limited Responses)

The Statement of Policy is designed to recognize the obligation of the auditor to complete the procedures considered necessary to satisfy himself as to the fair presentation of the company's financial condition and results, in order to render a report which includes an opinion not qualified because of a limitation on the scope of the audit. In this connection, reference is made to SEC Accounting Series Release No. 90 [*Financial Reporting Release No. 1, section 607.01(b)*], in which it is stated:

"A 'subject to' or 'except for' opinion paragraph in which these phrases refer to the scope of the audit, indicating that the accountant has not been able to satisfy himself on some significant element in the financial statements, is not acceptable in certificates filed with the Commission in connection with the public offering of securities. The 'subject to' qualification is appropriate when the reference is to a

middle paragraph or to footnotes explaining the status of matters which cannot be resolved at statement date."

Paragraph 5 (Loss Contingencies)

[Paragraph 5](#) of the Statement of Policy summarizes the categories of "loss contingencies" about which the lawyer may furnish information to the auditor. The term loss contingencies and the categories relate to concepts of accounting accrual and disclosure specified for the accounting profession in Statement of Financial Accounting Standards No. 5^{fn.†} ("FAS 5") issued by the Financial Accounting Standards Board in March, 1975.

5.1 Accounting Requirements

To understand the significance of the auditor's inquiry and the implications of any response the lawyer may give, the lawyer should be aware of the following accounting concepts and requirements set out in FAS 5:^{fn.#}

- a. A "loss contingency" is an existing condition, situation or set of circumstances involving uncertainty as to possible loss to an enterprise that will ultimately be resolved when one or more events occur or fail to occur. Resolutions of the uncertainty may confirm the loss or impairment of an asset or the incurrence of a liability. (Para. 1)
- b. When a "loss contingency" exists, the likelihood that a future event or events will confirm the loss or impairment of an asset or the incurrence of a liability can range from probable to remote. There are three areas within that range, defined as follows:
 - i. Probable — "The future event or events are likely to occur."
 - ii. Reasonably possible — "The chance of the future event or events occurring is more than remote but less than likely."
 - iii. Remote — "The chance of the future event or events occurring is slight." (Para. 3)
- c. *Accrual* in a client's financial statements by a charge to income of the period will be required if both the following conditions are met:
 - i. "Information available prior to issuance of the financial statements indicates that it is *probable* that an asset had been impaired or a liability had been incurred at the date of the financial statements. It is implicit in this condition that it must be *probable* that one or more future events will occur confirming the fact of the loss." (emphasis added; footnote omitted)
 - ii. "The amount of loss can be reasonably estimated." (Para. 8)
- d. If there is no *accrual* of the loss contingency in the client's financial statements because one of the two conditions outlined in (c) above are not met, disclosure may be required as provided in the following:

"If no accrual is made for a loss contingency because one or both of the conditions in [paragraph 8](#) are not met, or if an exposure to loss exists in excess of the amount accrued pursuant to the provisions of [paragraph 8](#), disclosure of the contingency shall be made when there is at least a reasonable possibility that a loss or an additional loss may have been incurred. The disclosure shall indicate the nature of the contingency and shall give an estimate of the possible loss or range of loss or state that such an estimate cannot be made. Disclosure is not required of a loss contingency involving an unasserted claim or assessment when there has been no manifestation by potential claimant of an awareness of a possible claim or assessment unless it is considered probable that a claim will be asserted and there is a reasonable possibility that the outcome will be unfavorable." (emphasis added; footnote omitted) (Para. 10)

e. The accounting requirements recognize or specify that (i) the opinions or views of counsel are not the sole source of audit evidence in making determinations about the accounting recognition or treatment to be given to litigation, and (ii) the fact that the lawyer is notable to express an opinion that the outcome will be favorable does not necessarily require an accrual of a loss. Paragraphs 36 and 37 of FAS 5 state as follows:

"If the underlying cause of the litigation, claim, or assessment is an event occurring before the date of an enterprise's financial statements, the probability of an outcome unfavorable to the enterprise must be assessed to determine whether the condition in paragraph 8(a) is met. Among the factors that should be considered are the nature of the litigation, claim, or assessment, the progress of the case (including progress after the date of the financial statements but before those statements are issued), the opinions or views of legal counsel and other advisers, the experience of the enterprise in similar cases, the experience of other enterprises, and any decision of the enterprise's management as to how the enterprise intends to respond to the lawsuit, claim, or assessment (for example, a decision to contest the case vigorously or a decision to seek an out-of-court settlement). The fact that legal counsel is unable to express an opinion that the outcome will be favorable to the enterprise should not necessarily be interpreted to mean that the condition for accrual of a loss in paragraph 8(a) is met.

"The filing of a suit or formal assertion of a claim or assessment does not automatically indicate that accrual of a loss may be appropriate. The degree of probability of an unfavorable outcome must be assessed. The condition for accrual in paragraph 8(a) would be met if an unfavorable outcome is determined to be probable. If an unfavorable outcome is determined to be reasonably possible but not probable, or if the amount of loss cannot be reasonably estimated, accrual would be inappropriate, but disclosure would be required by paragraph 10 of this Statement."

f. Paragraph 38 of FAS 5 focuses on certain examples concerning the determination by the enterprise whether an assertion of an *unasserted possible claim* may be considered probable:

"With respect to unasserted claims and assessments, an enterprise must determine the degree of probability that a suit may be filed or a claim or assessment may be asserted and the possibility of an unfavorable outcome. For example, a catastrophe, accident, or other similar physical occurrence predictably engenders claims for redress, and in such circumstances their assertion may be probable; similarly, an investigation of an enterprise by a governmental agency, if enforcement proceedings have been or are likely to be instituted, is often followed by private claims for redress, and the probability of their assertion and the possibility of loss should be considered in each case. By way of further example, an enterprise may believe there is a possibility that it has infringed on another enterprise's patent rights, but the enterprise owning the patent rights has not indicated an intention to take any action and has not even indicated an awareness of the possible infringement. In that case, a judgment must first be made as to whether the assertion of a claim is probable. If the judgment is that assertion is not probable, no accrual or disclosure would be required. On the other hand, if the judgment is that assertion is probable, then a second judgment must be made as to the degree of probability of an unfavorable outcome. If an unfavorable outcome is probable and the amount of loss can be reasonably estimated, accrual of a loss is required by paragraph 8. If an unfavorable outcome is probable but the amount of loss cannot be reasonably estimated, accrual would not be appropriate, but disclosure would be required by paragraph 10. If an unfavorable outcome is reasonably possible but not probable, disclosure would be required by paragraph 10."

For a more complete presentation of FAS 5, reference is made to AU section 337B, *Exhibit I — Excerpts From Financial Accounting Standards Board Accounting Standards Codification 450, Contingencies* [SAS No. 12 section 337B],^{fn.**} in which are set forth excerpts selected by the AICPA as relevant to a Statement on Auditing Standards, issued by its Auditing Standards Executive Committee, captioned "Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments."

5.2 *Lawyer's Response*

Concepts of probability inherent in the usage of terms like "probable" or "reasonably possible" or "remote" mean different things in different contexts. Generally, the outcome of, or the loss which may result from, litigation cannot be assessed in any way that is comparable to a statistically or empirically

determined concept of "probability" that may be applicable when determining such matters as reserves for warranty obligations or accounts receivable or loan losses when there is a large number of transactions and a substantial body of known historical experience for the enterprise or comparable enterprises. While lawyers are accustomed to counseling clients during the progress of litigation as to the possible amount required for settlement purposes, the estimated risks of the proceedings at particular times and the possible application or establishment of points of law that may be relevant, such advice to the client is not possible at many stages of the litigation and may change dramatically depending upon the development of the proceedings. Lawyers do not generally quantify for clients the "odds" in numerical terms; if they do, the quantification is generally only undertaken in an effort to make meaningful, for limited purposes, a whole host of judgmental factors applicable at a particular time, without any intention to depict "probability" in any statistical, scientific or empirically-grounded sense. Thus, for example, statements that litigation is being defended vigorously and that the client has meritorious defenses do not, and do not purport to, make a statement about the probability of outcome in any measurable sense.

Likewise, the "amount" of loss — that is, the total of costs and damages that ultimately might be assessed against a client — will, in most litigation, be a subject of wide possible variance at most stages; it is the rare case where the amount is precise and where the question is whether the client against which claim is made is liable either for all of it or none of it.

In light of the foregoing considerations, it must be concluded that, as a general rule, it should not be anticipated that meaningful quantifications of "probability" of outcome or amount of damages can be given by lawyers in assessing litigation. To provide content to the definitions set forth in [Paragraph 5](#) of the Statement of Policy, this Commentary amplifies the meanings of the terms under discussion, as follows:

"probable" — An unfavorable outcome is normally "probable" if, but only if, investigation, preparation (including development of the factual data and legal research) and progress of the matter have reached a stage where a judgment can be made, taking all relevant factors into account which may affect the outcome, that it is extremely doubtful that the client will prevail.

"remote" — The prospect for an unfavorable outcome appears, at the time, to be slight; i.e., it is extremely doubtful that the client will not prevail. Normally, this would entail the ability to make an unqualified judgment, taking into account all relevant factors which may affect the outcome, that the client may confidently expect to prevail on a motion for summary judgment on all issues due to the clarity of the facts and the law.

In other words, for purposes of the lawyer's response to the request to advise auditors about litigation, an unfavorable outcome will be "probable" only if the chances of the client prevailing appear slight and of the claimant losing appear extremely doubtful; it will be "remote" when the client's chances of losing appear slight and of not winning appear extremely doubtful. It is, therefore, to be anticipated that, in most situations, an unfavorable outcome will be neither "probable" nor "remote" as defined in the Statement of Policy.

The discussion above about the very limited basis for furnishing judgments about the outcome of litigation applies with even more force to a judgment concerning whether or not the assertion of a claim not yet asserted is "probable." That judgment will infrequently be one within the professional competence of lawyers and therefore the lawyer should not undertake such assessment except where such judgment may become meaningful because of the presence of special circumstances, such as catastrophes, investigations and previous public disclosure as cited in [Paragraph 5](#) of the Statement of Policy, or similar extrinsic evidence relevant to such assessment. Moreover, it is unlikely, absent relevant extrinsic evidence, that the client or anyone else will be in a position to make an informed judgment that assertion of a possible claim is "probable" as opposed to "reasonably possible" (in which event disclosure is not required). In light of the legitimate concern that the public interest would not be well served by resolving uncertainties in a way that invites the assertion of claims or otherwise causes unnecessary harm to the client and its stockholders, a decision to treat an unasserted claim as "probable" of assertion should be based only upon compelling judgment.

Consistent with these limitations believed appropriate for the lawyer, he should not represent to the auditor, nor should any inference from his response be drawn, that the unasserted possible claims identified by the client (as contemplated by [Paragraph 5\(c\)](#) of the Statement of Policy) represent all such claims of which the lawyer may be aware or that he necessarily concurs in his client's determination of which unasserted possible claims warrant specification by the client; within proper limits, this determination is one which the client is entitled to make — and should make — and it would be inconsistent with his professional obligations for the lawyer to volunteer information arising from his confidential relationship with his client.

As indicated in [Paragraph 5](#), the lawyer also may be asked to estimate the potential loss (or range) in the event that an unfavorable outcome is not viewed to be "remote." In such a case, the lawyer would provide an estimate only if he believes that the probability of inaccuracy of the estimate of the range or amount is slight. What is meant here is that the estimate of amount of loss presents the same difficulty as assessment of outcome and that the same formulation of "probability" should be used with respect to the determination of estimated loss amounts as should be used with respect to estimating the outcome of the matter.

In special circumstances, with the proper consent of the client, the lawyer may be better able to provide the auditor with information concerning loss contingencies through conferences where there is opportunity for more detailed discussion and interchange. However, the principles set forth in the Statement of Policy and this Commentary are fully applicable to such conferences.

Subsumed throughout this discussion is the ongoing responsibility of the lawyer to assist his client, at the client's request, in complying with the requirements of FAS 5 to the extent such assistance falls within his professional competence. This will continue to involve, to the extent appropriate, privileged discussions with the client to provide a better basis on which the client can make accrual and disclosure determinations in respect of its financial statements.

In addition to the considerations discussed above with respect to the making of any judgment or estimate by the lawyer in his response to the auditor, including with respect to a matter specifically identified by the client, the lawyer should also bear in mind the risk that the furnishing of such a judgment or estimate to any one other than the client might constitute an admission or be otherwise prejudicial to the client's position in its defense against such litigation or claim (see [Paragraph 1](#) of the Statement of Policy and of this Commentary).

Paragraph 6 (Lawyer's Professional Responsibility)

The client must satisfy whatever duties it has relative to timely disclosure, including appropriate disclosure concerning material loss contingencies, and, to the extent such matters are given substantive attention in the form of legal consultation, the lawyer, when his engagement is to advise his client concerning a disclosure obligation, has a responsibility to advise his client concerning its obligations in this regard. Although lawyers who normally confine themselves to a legal specialty such as tax, antitrust, patent or admiralty law, unlike lawyers consulted about SEC or general corporate matters, would not be expected to advise generally concerning the client's disclosure obligations in respect of a matter on which the lawyer is working, the legal specialist should counsel his client with respect to the client's obligations under FAS 5 to the extent contemplated herein. Without regard to legal specialty, the lawyer should be mindful of his professional responsibility to the client described in [Paragraph 6](#) of the Statement of Policy concerning disclosure.

The lawyer's responsibilities with respect to his client's disclosure obligations have been a subject of considerable discussion and there may be, in due course, clarification and further guidance in this regard. In any event, where in the lawyer's view it is clear that (i) the matter is of material importance and seriousness, and (ii) there can be no reasonable doubt that its non-disclosure in the client's financial statements would be a violation of law giving rise to material claims, rejection by the client of his advice to call the matter to the attention of the auditor would almost certainly require the lawyer's withdrawal from employment in accordance with the Code of Professional Responsibility. (See, e.g., Disciplinary Rule 7-102 (A)(3) and (7), and Disciplinary Rule 2-110 (B)(2).) Withdrawal under such circumstances is obviously undesirable and might present serious problems for the client.

Accordingly, in the context of financial accounting and reporting for loss contingencies arising from unasserted claims, the standards for which are contained in FAS 5, clients should be urged to disclose to the auditor information concerning an unasserted possible claim or assessment (not otherwise specifically identified by the client) where in the course of the services performed for the client it has become clear to the lawyer that (i) the client has no reasonable basis to conclude that assertion of the claim is not probable (employing the concepts hereby enunciated) and (ii) given the probability of assertion, disclosure of the loss contingency in the client's financial statements is beyond reasonable dispute required.

Paragraph 7 (Limitation on Use of Response)

Some inquiry letters make specific reference to, and one might infer from others, an intention to quote verbatim or include the substance of the lawyer's reply in footnotes to the client's financial statements. Because the client's prospects in pending litigation may shift as a result of interim developments, and because the lawyer should have an opportunity, if quotation is to be made, to review the footnote in full, it would seem prudent to limit the use of the lawyer's reply letter. [Paragraph 7](#) sets out such a limitation.

[Paragraph 7](#) also recognizes that it may be in the client's interest to protect information contained in the lawyer's response to the auditor, if and to the extent possible, against unnecessary further disclosure or use beyond its intended purpose of informing the auditor. For example, the response may contain information which could prejudice efforts to negotiate a favorable settlement of a pending litigation described in the response. The requirement of consent to further disclosure, or of reasonable advance notice where disclosure may be required by court process or necessary in defense of the audit, is designed to give the lawyer an opportunity to consult with the client as to whether consent should be refused or limited or, in the case of legal process or the auditor's defense of the audit, as to whether steps can and should be taken to challenge the necessity of further disclosure or to seek protective measures in connection therewith. It is believed that the suggested standard of twenty days advance notice would normally be a minimum reasonable time for this purpose.

Paragraph 8 (General)

It is reasonable to assume that the Statement of Policy will receive wide distribution and will be readily available to the accounting profession. Specifically, the Statement of Policy has been reprinted as Exhibit II to the Statement on Auditing Standards, "Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments," issued by the Auditing Standards Executive Committee of the American Institute of Certified Public Accountants. Accordingly, the mechanic for its incorporation by reference will facilitate lawyer-auditor communication. The incorporation is intended to include not only limitations, such as those provided by [Paragraphs 2](#) and [7](#) of the Statement of Policy, but also the explanatory material set forth in this Commentary.

Annex A

[Illustrative forms of letters for full response by outside practitioner or law firm and inside general counsel to the auditor's inquiry letter. These illustrative forms, which are not part of the Statement of Policy, have been prepared by the Committee on Audit Inquiry Responses solely in order to assist those who may wish to have, for reference purposes, a form of response which incorporates the principles of the Statement of Policy and accompanying Commentary. Other forms of response letters will be appropriate depending on the circumstances.]

Illustrative Form of Letter for Use by Outside Practitioner or Law Firm:

[Name and Address of Accounting Firm]

Re: [Name of Client] [and Subsidiaries]

Dear Sirs:

By letter date *[insert date of request]* Mr. *[insert name and title of officer signing request]* of *[insert name of client]* *[(the "Company") or (together with its subsidiaries, the "Company")]* has requested us to furnish you with certain information in connection with your examination of the accounts of the Company as at *[insert fiscal year-end]*.

[Insert description of the scope of the lawyer's engagement; the following are sample descriptions:]

While this firm represents the Company on a regular basis, our engagement has been limited to specific matters as to which we were consulted by the Company.

[or]

We call your attention to the fact that this firm has during the past year represented the Company only in connection with certain *[Federal income tax matters]* *[litigation]* *[real estate transactions]* *[describe other specific matters, as appropriate]* and has not been engaged for any other purpose.

Subject to the foregoing and to the last paragraph of this letter, we advise you that since *[insert date of beginning of fiscal period under audit]* we have not been engaged to give substantive attention to, or represent the Company in connection with, *[material]*^{fn.††} loss contingencies coming within the scope of [clause \(a\)](#) of Paragraph 5 of the Statement of Policy referred to in the last paragraph of this letter, except as follows:

[Describe litigation and claims which fit the foregoing criteria.]

[If the inquiry letter requests information concerning specified unasserted possible claims or assessments and/or contractually assumed obligations:]

With respect to the matters specifically identified in the Company's letter and upon which comment has been specifically requested, as contemplated by [clauses \(b\) or \(c\)](#) of Paragraph 5 of the ABA Statement of Policy, we advise you, subject to the last paragraph of this letter, as follows:

[Insert information as appropriate]

The information set forth herein is *[as of the date of this letter]* *[as of (insert date), the date on which we commenced our internal review procedures for purposes of preparing this response]*, except as otherwise noted, and we disclaim any undertaking to advise you of changes which thereafter may be brought to our attention.

[Insert information with respect to outstanding bills for services and disbursements.]

This response is limited by, and in accordance with, the ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information (December 1975); without limiting the generality of the foregoing, the limitations set forth in such Statement on the scope and use of this response ([Paragraphs 2 and 7](#)) are specifically incorporated herein by reference, and any description herein of any "loss contingencies" is qualified in its entirety by [Paragraph 5](#) of the Statement and the accompanying [Commentary](#) (which is an integral part of the Statement). Consistent with the last sentence of [Paragraph 6](#) of the ABA Statement of Policy and pursuant to the Company's request, this will confirm as correct the Company's understanding as set forth in its audit inquiry letter to us that whenever, in the course of performing legal services for the Company with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, we have formed a professional conclusion that the Company must disclose or consider disclosure concerning such possible claim or assessment, we, as a matter of professional responsibility to the Company, will so advise the Company and will consult with the Company concerning the question of such disclosure and the applicable requirements of Statement of Financial Accounting Standards No. 5.^{fn.†} *[Describe any other or additional limitation as indicated by [Paragraph 4](#) of the Statement]*

Very truly yours,

Illustrative Form of Letter for Use by Inside General Counsel:

[*Name and Address of Accounting Firm*]

Re: [*Name of Company*] [*and Subsidiaries*]

Dear Sirs:

As General Counsel^{fn **} of [*insert name of client*] [(*the "Company"*)] [(*together with its subsidiaries, the "Company"*)], I advise you as follows in connection with your examination of the accounts of the Company as at [*insert fiscal year-end*].

I call your attention to the fact that as General Counsel^{fn **} for the Company I have general supervision of the Company's legal affairs. [*If the general legal supervisory responsibilities of the person signing the letter are limited, set forth here a clear description of those legal matters over which such person exercises general supervision, indicating exceptions to such supervision and situations where primary reliance should be placed on other sources.*] In such capacity, I have reviewed litigation and claims threatened or asserted involving the Company and have consulted with outside legal counsel with respect thereto where I have deemed appropriate.

Subject to the foregoing and to the last paragraph of this letter, I advise you that since [*insert date of beginning of fiscal period under audit*] neither I, nor any of the lawyers over whom I exercise general legal supervision, have given substantive attention to, or represented the Company in connection with, [*material*]^{fn **} loss contingencies coming within the scope of [clause \(a\)](#) of Paragraph 5 of the Statement of Policy referred to in the last paragraph of this letter, except as follows:

[*Describe litigation and claims which fit the foregoing criteria.*]

[*If information concerning specified unasserted possible claims or assessments and/or contractually assumed obligations is to be supplied:*]

With respect to matters which have been specifically identified as contemplated by [clauses \(b\) or \(c\)](#) of Paragraph 5 of the ABA Statement of Policy, I advise you, subject to the last paragraph of this letter, as follows:

[*Insert information as appropriate*]

The information set forth herein is [*as of the date of this letter*] as of [*insert date*], the date on which we commenced our internal review procedures for purposes of preparing this response, except as otherwise noted, and I disclaim any undertaking to advise you of changes which thereafter may be brought to my attention or to the attention of the lawyers over whom I exercise general legal supervision.

This response is limited by, and in accordance with, the ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information (December 1975); without limiting the generality of the foregoing, the limitations set forth in such Statement on the scope and use of this response ([Paragraphs 2](#) and [7](#)) are specifically incorporated herein by reference, and any description herein of any "loss contingencies" is qualified in its entirety by [Paragraph 5](#) of the Statement and the accompanying [Commentary](#) (which is an integral part of the Statement). Consistent with the last sentence of [Paragraph 6](#) of the ABA Statement of Policy, this will confirm as correct the Company's understanding that whenever, in the course of performing legal services for the Company with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, I have formed a professional conclusion that the Company must disclose or consider disclosure concerning such possible claim or assessment, I, as a matter of professional responsibility to the Company, will so advise the Company and will consult with the

Company concerning the question of such disclosure and the applicable requirements of Statement of Financial Accounting Standards No. 5.^{fn 1} [Describe any other or additional limitation as indicated by [Paragraph 4](#) of the Statement.]

Very truly yours,

[Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 143, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 144, July 2021.]

Exhibit B — Report of the Subcommittee on Audit Inquiry Responses^{fn 1}

.A91

Because of a recent court case and other judicial decisions involving lawyers' responses to auditors' requests for information, an area of uncertainty or concern has been brought to the Subcommittee's attention and is the subject of the following comment:

This Committee's report does not modify the ABA Statement of Policy, nor does it constitute an interpretation thereof. The Preamble to the ABA Statement of Policy states as follows:

Both the Code of Professional Responsibility and the cases applying the evidentiary privilege recognize that the privilege against disclosure can be knowingly and voluntarily waived by the client. It is equally clear that disclosure to a third party may result in loss of the "confidentiality" essential to maintain the privilege. Disclosure to a third party of the lawyer-client communication on a particular subject may also destroy the privilege as to other communications on that subject. Thus, the mere disclosure by the lawyer to the outside auditor, with due client consent, of the substance of communications between the lawyer and client may significantly impair the client's ability in other contexts to maintain the confidentiality of such communications.

Under the circumstances a policy of audit procedure which requires clients to give consent and authorize lawyers to respond to general inquiries and disclose information to auditors concerning matters which have been communicated in confidence is essentially destructive of free and open communication and early consultation between lawyer and client. The institution of such a policy would inevitably discourage management from discussing potential legal problems with counsel for fear that such discussion might become public and precipitate a loss to or possible liability of the business enterprise and its stockholders that might otherwise never materialize.

It is also recognized that our legal, political, and economic systems depend to an important extent on public confidence in published financial statements. To meet this need the accounting profession must adopt and adhere to standards and procedures that will command confidence in the auditing process. It is not, however, believed necessary, or sound public policy, to intrude upon the confidentiality of the lawyer-client relationship in order to command such confidence. On the contrary, the objective of fair disclosure in financial statements is more likely to be better served by maintaining the integrity of the confidential relationship between lawyer and client, thereby strengthening corporate management's confidence in counsel and to act in accordance with counsel's advice.

[Paragraph 1](#) of the ABA Statement of Policy provides as follows:

1. Client Consent to Response. The lawyer may properly respond to the auditor's requests for information concerning loss contingencies (the term and concept established by Statement of Financial Accounting Standards No. 5, promulgated by the Financial Accounting Standards Board in March 1975 and discussed in [Paragraph 5.1](#) of the accompanying commentary), to the extent hereinafter set forth, subject to the following:

a. Assuming that the client's initial letter requesting the lawyer to provide information to the auditor is signed by an agent of the client having apparent authority to make such a request, the lawyer may

provide to the auditor information requested, without further consent, unless such information discloses a confidence or a secret or requires an evaluation of a claim.

b. In the normal case, the initial request letter does not provide the necessary consent to the disclosure of a confidence or secret or to the evaluation of a claim since that consent may only be given after full disclosure to the client of the legal consequences of such action.

c. Lawyers should bear in mind, in evaluating claims, that an adverse party may assert that any evaluation of potential liability is an admission.

d. In securing the client's consent to the disclosure of confidences or secrets, or the evaluation of claims, the lawyer may wish to have a draft of his letter reviewed and approved by the client before releasing it to the auditor; in such cases, additional explanation would in all probability be necessary so that the legal consequences of the consent are fully disclosed to the client.

In order to preserve explicitly the evidentiary privileges, some lawyers have suggested that clients include language in the following or substantially similar form:

We do not intend that either our request to you to provide information to our auditor or your response to our auditor should be construed in any way to constitute a waiver of the attorney-client privilege or the attorney work-product privilege.

If client's request letter does not contain language similar to that in the preceding paragraph, the lawyer's statement that the client has so advised him or her may be based upon the fact that the client has in fact so advised the lawyer, in writing or orally, in other communications or in discussions.

For the same reason, the response letter from some lawyers also includes language in the following or substantially similar form:

The Company [*or other defined term*] has advised us that, by making the request set forth in its letter to us, the Company [*or other defined term*] does not intend to waive the attorney-client privilege with respect to any information which the Company [*or other defined term*] has furnished to us. Moreover, please be advised that our response to you should not be construed in any way to constitute a waiver of the protection of the attorney work-product privilege with respect to any of our files involving the Company [*or other defined term*].

We believe that language similar to the foregoing in letters of the client or the lawyer simply makes explicit what has always been implicit, namely, it expressly states clearly that neither the client nor the lawyer intended a waiver. It follows that non-inclusion of either or both of the foregoing statements by the client or the lawyer in their respective letters at any time in the past or the future would not constitute an expression of intent to waive the privileges.

On the other hand, the inclusion of such language does not necessarily assure the client that, depending on the facts and circumstances, a waiver may not be found by a court of law to have occurred.

We do not believe that the foregoing types of inclusions cause a negative impact upon the public policy considerations described in the Preamble to the ABA Statement of Policy nor do they intrude upon the arrangements between the legal profession and the accounting profession contemplated by the ABA Statement of Policy. Moreover, we do not believe that such language interferes in any way with the standards and procedures of the accounting profession in the auditing process nor should it be construed as a limitation upon the lawyer's reply to the auditors. We have been informed that the Auditing Standards Board of the AICPA has adopted an interpretation of SAS 12 recognizing the propriety of these statements.

Lawyers, in any case, should be encouraged to have their draft letters to auditors reviewed and approved by the client before releasing them to the auditors and may wish to explain to the client the

legal consequences of the client's consent to lawyer's response as contemplated by [subparagraph 1\(d\)](#) of the Statement of Policy.

[Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 143, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 144, July 2021.]

Exhibit C – Statement on Updates to Audit Response Letters^{fn *}

.A92

By Audit Responses Committee, ABA Business Law Section

Requests for updates to lawyers' audit response letters have become more frequent in recent years. Typically, the client's audit inquiry letter to its lawyers calls for a response before the anticipated issuance date of the audited financial statements. An "update" or "bringdown" is an audit response letter provided to the auditor in which a lawyer provides information about loss contingencies as of a date after the date of the lawyer's initial response to the audit inquiry letter and any previous update.

The *ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Requests*^{fn.1} does not specifically discuss updates to audit response letters. In view of the increased frequency of update requests and the lack of guidance regarding these requests, the ABA Business Law Section Audit Responses Committee has prepared this statement to outline the reasons auditors seek updates of audit response letters and to present the Committee's views on appropriate practices for responding to update requests under the *ABA Statement of Policy*. The Committee hopes that the guidance provided in this Statement will enhance the ability of lawyers to respond efficiently to update requests, thereby facilitating the audit process and contributing to audit quality.

The Reasons for Update Requests

The *ABA Statement of Policy*, including its reference to accounting and auditing standards, provides the framework for lawyers' audit response letters. The *ABA Statement of Policy* recognizes the fundamental importance to the American legal system of maintaining client confidences. It makes clear that lawyers may provide information to auditors only at the request, and with the express consent, of their clients.^{fn.2} In accordance with the *ABA Statement of Policy*, lawyers typically indicate in their audit response letters that the information they are furnishing is as of a specified date and disclaim any undertaking to advise the auditor of changes that may later be brought to the lawyer's attention.^{fn.3} The *ABA Statement of Policy* also contemplates that "the auditor may assume that the firm or department has endeavored, to the extent believed necessary by the firm or department, to determine from lawyers currently in the firm or department who have performed services for the client since the beginning of the fiscal period under audit whether such services involved substantive attention in the form of legal consultation concerning" loss contingencies.^{fn.4}

In recent years, requests for updates have become standard procedure for many auditors. This reflects changes in applicable accounting standards and auditing practices, as well as increased emphasis on loss contingencies by the Securities and Exchange Commission ("SEC") and Financial Accounting Standards Board ("FASB"), which in turn has increased auditors' focus on loss contingencies. Requests for updates to audit response letters typically are made in three contexts:

- *Audit of annual financial statements.* Changes to financial reporting standards require the entity's management to evaluate "subsequent events," which can include changes in loss contingencies, through the date the financial statements are issued or are available to be issued.^{fn.5}

As a result of changes in auditing practices,^{fn.6} most auditors' reports are now dated as of the date the financial statements are issued or are available to be issued, as opposed to the date on which fieldwork is completed. Accordingly, the auditor may seek to obtain audit evidence, in the form of

audit letter updates, to corroborate management's identification of and accounting for loss contingencies as of the issuance date.

- *Review of quarterly financial statements.* As with annual financial statements, an entity is required to consider subsequent events, including loss contingencies, through the date of issuance of its quarterly financial statements. SEC rules require that quarterly financial statements be reviewed by the entity's external auditors in accordance with relevant auditing standards.^{fn.7} Although they are not ordinarily required to do so,^{fn.8} auditors may request confirmation from counsel about loss contingencies as part of their internal procedures before they will sign off on the filing of quarterly financial statements with the SEC.
- *Consents in connection with registered securities offerings.* Auditors must consent to the use of their audit reports in registration statements for public offerings of securities. Auditing standards require the auditors to perform certain procedures before consenting to the inclusion of a previously issued audit report in a registration statement or amendment to a registration statement.^{fn.9} Although these standards do not require an auditor to make inquiries of lawyers, before issuing a consent, many auditors ask lawyers to update their audit response letters. In offerings involving shelf takedowns, the auditors may request one or more updates in connection with their delivery of "comfort letters" to underwriters.

The foregoing explains the increased frequency of auditors' requests for updates. However, the experience of many lawyers suggests that auditors (and sometimes clients) do not always appreciate the need for lawyers to perform internal procedures to be able to deliver an update.

Lawyers' Responses to Update Requests — A Framework

A lawyer's update to an audit response letter is subject to the *ABA Statement of Policy* and should be prepared and delivered in accordance with its terms. This has several implications.

Client Requests for Updates to Audit Response Letters. As with the initial response letter, a lawyer may only provide information to the auditor at the client's request, even if, as is often the case, the auditor requests the update directly. The lawyer should be satisfied that the client has provided the necessary authorization for the update. The Committee does not believe that any specific form of authorization is necessary, so long as it expresses the client's intent that the lawyer deliver an update to the lawyer's response letter to the auditor. A lawyer may rely on any form of written request, including electronic mail. The Committee believes that lawyers may also rely on oral requests for an update, though it may be advisable for them to document such requests.

Standing Requests. In some cases, a client's initial request letter may contain a standing request that the lawyer deliver updates to response letters upon request by the auditor. The inclusion of such a request can facilitate the audit response process. Many lawyers view a client request to provide information to the auditors in connection with the audit of the annual financial statements to include an implicit standing request to respond to update requests related to issuance of those financial statements. Other lawyers require a separate authorization for every update, absent a standing request.

The Committee believes that lawyers may provide an update on the basis of a standing request, but recognizes that in some circumstances they may want a specific request or consent from the client. Among those circumstances are (1) when significant time has elapsed since the initial request, and (2) when developments have occurred that would be required to be reported in the update, such as pending or threatened litigation that has arisen since the previous response or significant developments in previously described pending or threatened litigation, and the lawyer believes the client should be consulted before issuing the update response.

Preparation of Updates to Audit Response Letters. The Committee recognizes that circumstances may allow lawyers significantly less time to prepare an update than they had for the initial response letter. Still, clients and auditors should recognize that because, from the lawyers' standpoint, each update is tantamount to reissuance of the initial response letter, lawyers may have to perform internal review

procedures similar to those performed for the initial response letter. Those may include inquiring again of lawyers in the law firm or law department who may have relevant information. Clients should be encouraged to communicate with their lawyers and the auditor when the client becomes aware of a filing or transaction that will require an update to an audit response letter, so that the lawyers have adequate time to perform sufficient internal review procedures to provide the update.^{fn 10}

The internal procedures lawyers perform to issue an update will depend on the particular circumstances and the professional judgment of the lawyers involved as to what is necessary. For example, some law firms or law departments may canvass the lawyers who provided information reflected in the earlier response to the audit inquiry letter, even if those lawyers have not subsequently recorded time for the client. Other firms or law departments may only canvass lawyers who have performed legal services for the client since the cutoff date for the last internal inquiry and any other lawyers they believe are likely to have relevant information. The Committee believes that either approach is acceptable. The Committee recognizes that the professional judgment of lawyers may lead to different procedures in particular cases, which might involve varying types and amount of inquiry and documentation.

Form of Updates to Audit Response Letters. Updates ordinarily should be delivered in writing, not communicated orally. Any update to an audit response letter should be made in accordance with the *ABA Statement of Policy*, including its conditions and limitations. Unlike lawyers' initial responses to audit inquiry letters, no illustrative form of update response has been established, and many different forms are in common use.

Some lawyers regularly use a "long form" response letter that employs the same form as the initial response letter but provides information about loss contingencies as of an effective date after the effective date of the previous letter. Others use a "short form" letter that does not contain all the language of a long-form letter, but rather references the information in the previous letter and identifies any reportable developments with respect to previously reported loss contingencies or reportable loss contingencies that have arisen since the prior effective date. Finally, some lawyers have adopted a hybrid approach under which they use a short form in some circumstances and a long form in others; these lawyers may use a short form when they have no developments to report since the previous response letter and a long form when additional information about loss contingencies (whether previously reported or new) needs to be reported.

If a short form is used, the Committee suggests that it should (1) refer to the relevant client request(s), the entity or entities covered by the response, and the most recent long form response letter and previous update letters, if any, identifying them by date, and (2) state expressly that the response is subject to the same limitations and qualifications contained in the earlier letter. Nothing in this statement is intended to limit the professional judgment of a lawyer regarding the form the lawyer uses to update an audit response letter.

[Paragraph added, June 2015, to reflect *Statement on Updates to Audit Response Letter* by the Audit Responses Committee of the American Bar Association. Revised, February 2017, to better reflect the AICPA Council Resolution designating the PCAOB to promulgate technical standards. Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 143, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 144, July 2021.]

[fn 1] [Footnote deleted by the issuance of SAS No. 143, July 2020.]

fn 2 [Section 330](#), *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, addresses the auditor's procedures to respond to the assessed risks of material misstatements at the relevant assertion level.

fn 3 For purposes of this section, the term *legal counsel* refers to the entity's in-house legal counsel and external legal counsel.

[fn 4-fn 6] [Footnotes deleted by the issuance of SAS No. 143, July 2020.]

[fn 7] [Footnote deleted by the issuance of SAS No. 144, June 2021.]

fn 8 [Paragraphs .23-.24](#) of section 330.

fn 9 [Paragraph .A13](#) of section 510, *Opening Balances — Initial Audit Engagements, Including Reaudit Engagements*.

fn 10 [Paragraph .15](#) of section 580, *Written Representations*.

fn 11 [Paragraph .12](#) of section , *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

fn 12 The *Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information* is reprinted as [exhibit A](#), "American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information," for the convenience of readers but is not an integral part of this section.

fn 13 [Paragraph .43](#) of section 700, *Forming an Opinion and Reporting on Financial Statements*, or [paragraphs .82 and .126](#) of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

fn 14 [Paragraph .07](#) of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

fn 15 [Paragraph .13](#) of section 705.

fn 16 [Paragraph .A14](#) of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

fn 17 See [section 265](#), *Communicating Internal Control Related Matters Identified in an Audit*, for further guidance. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142.]

fn 18 See [paragraph .07](#) of section 500, *Audit Evidence*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

fn 19 [Paragraph .07](#) of section 620, *Using the Work of an Auditor's Specialist*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Footnote renumbered by the issuance of SAS No. 144, June 2021.]

fn 20 [Paragraph .21](#) of section 540, *Auditing Accounting Estimates and Related Disclosures*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

fn * Statement on Auditing Standards No. 12 section 337C, *Exhibit II — American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information*, has been superseded by this section.

fn † In July 2009, the Financial Accounting Standards Board (FASB) issued FASB *Accounting Standards Codification* (ASC) as authoritative. FASB ASC is now the source of authoritative U.S. accounting and reporting standards for nongovernmental entities, in addition to guidance promulgated by the Securities and Exchange Commission (SEC). As of July 1, 2009, all other nongrandfathered, non-SEC accounting literature not included in FASB ASC became nonauthoritative. FASB Statement No. 5, *Accounting for Contingencies*, has been codified as FASB ASC 450, *Contingencies*.

fn ‡ As contemplated by [Paragraph 8](#) of this Statement of Policy, this sentence is intended to be the subject of incorporation by reference as therein provided.

fn || Under FAS 5, when there has been no manifestation by a potential claimant of an awareness of a possible claim or assessment, disclosure of an unasserted possible claim is required only if the enterprise concludes that (i) it is probable that a claim will be asserted, (ii) there is a reasonable possibility, if the claim is in fact asserted, that the outcome will be unfavorable, and (iii) the liability resulting from such unfavorable outcome would be material to its financial condition.

fn # Citations are to paragraph numbers of FAS 5.

fn ** Statement on Auditing Standards No. 12 section 337B, *Exhibit I — Excerpts From Financial Accounting Standards Board Accounting Standards Codification 450, Contingencies*, has been withdrawn by this section.

fn †† **Note:** See [Paragraph 3](#) of the Statement of Policy and the accompanying Commentary for guidance where the response is limited to material items.

fn †† It may be appropriate in some cases for the response to be given by inside counsel other than inside general counsel, in which event this letter should be appropriately modified.

fn 1 Excerpted from "Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information," *The Business Lawyer* 31, no. 3 (1976). Reprinted by permission of the American Bar Association.

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fn 1 *American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information*, 31 BUS. LAW. 1709 (1976) [hereinafter *ABA Statement of Policy*], reprinted in ABA BUS. LAW SECTION AUDIT RESPONSES COMM., AUDITOR'S LETTER HANDBOOK 1 (2d ed. 2013).

fn 2 *Id.* at 2–3 (¶ 1).

fn 3 *Id.* at 3 (¶ 2) ("It is also appropriate for the lawyer to indicate the date as of which information is furnished and to disclaim any undertaking to advise the auditor of changes which may thereafter be brought to the lawyer's attention.").

fn 4 *Id.* Although a law firm's or law department's internal review procedure may include canvassing lawyers who performed services for a client from the beginning of the fiscal period under audit, many firms or departments limit their response to matters existing at the end of that period or arising after the end of the period. This approach is based upon the statement in the typical request letter to the effect that the response should include matters that existed at the end of the fiscal period under audit and during the period from that date to the date as of which the

response is given. See INTERIM AUDITING STANDARDS, [AU § 337A](#) (Pub. Co. Accounting Oversight Bd. 2003) (illustrative audit inquiry letter); CODIFICATION OF STATEMENTS ON AUDITING STANDARDS, Statement on Auditing Standards No. 122, [AU-C § 501.A69](#) (Am. Inst. of Certified Pub. Accountants 2011) (illustrative audit inquiry letter). Thus, under this approach, matters resolved during the fiscal period, which no longer comprise “loss contingencies” at or after the fiscal period end date, are not reported.

fn 5 See SUBSEQUENT EVENTS, Accounting Standards Codification, Topic 855 (Fin. Accounting Standards Bd. 2010) [hereinafter ASC 855]. ASC 855 codifies a prior accounting standard on subsequent events. See SUBSEQUENT EVENTS, Statement of Fin. Accounting Standards, No. 165 (Fin. Accounting Standards Bd. 2009) [hereinafter SFAS 165]. Notably, SFAS 165 amended the accounting standard governing contingencies. See ACCOUNTING FOR CONTINGENCIES, Statement of Fin. Accounting Standards No. 5 (Fin. Accounting Standards Bd. 1975), amended by SFAS 165, ¶ B3 (codified as CONTINGENCIES, Accounting Standards Codification, Topic 450 (Fin. Accounting Standards Bd. 2009)) [hereinafter ASC 450]. As amended, ASC 450 provides that, in assessing the accounting for a loss contingency, the reporting entity must consider information available through the date the financial statements were issued or available to be issued. See *id.* 450-20-25. Under ASC 855, for SEC filers, financial statements are “issued” on the date they are filed with the SEC; for non-SEC filers, they are “available to be issued” when they are complete and all internal approvals for issuance have occurred. ASC 855-10-25. ASC 855 also requires that entities disclose in the financial statements the date through which they evaluated subsequent events. See *id.* 855-10-50.

fn 6 In connection with its adoption of [Auditing Standard No. 5](#) in 2007, the Public Company Accounting Oversight Board amended Interim Auditing Standard [AU 530](#) to provide that “the auditor should date the audit report no earlier than the date on which the auditor has obtained sufficient appropriate evidence to support the auditor’s opinion.” INTERIM AUDITING STANDARDS, [AU § 530.01](#) (Pub. Co. Accounting Oversight Bd. 2007). Previously, [AU 530](#) had provided that generally the date of completion of the field work should be used as the date of the report. See Proposed Auditing Standard — An Audit of Internal Control over Financial Reporting that Is Integrated with an Audit of Financial Statements and Related Other Proposals, PCAOB Release No. 2006-007, at 34 (Dec. 19, 2006), available at http://pcaobus.org/Rules/Documents/2006-12-19_Release_No._2006-007.pdf. The PCAOB also amended its Interim Auditing Standards to provide that “the latest date of the period covered by the lawyer’s response (the ‘effective date’) should be as close to the date of the auditor’s report as is practicable in the circumstances.” INTERIM AUDITING STANDARDS, [AU § 9337.05](#) (Pub. Co. Accounting Oversight Bd. 2007). Previously, the standard had said that the effective date should be “as close to the completion of field work” as practicable in the circumstances. INTERIM AUDITING STANDARDS, [AU § 9337.05](#) (Pub. Co. Accounting Oversight Bd. 2003).

fn 7 Regulation S-X, Rule 10-01(d), 17 C.F.R. § 210.10-01(d) (2014).

fn 8 See INTERIM AUDITING STANDARDS, [AU § 722.20](#) (Pub. Co. Accounting Oversight Bd. 2003); CODIFICATION OF AUDITING STANDARDS AND PROCEDURES, Statement on Auditing Standards No. 100, [AU § 722.20](#) (Am. Inst. of Certified Pub. Accountants 2002), *superseded by* CODIFICATION OF STATEMENTS ON AUDITING STANDARDS, Statement on Auditing Standards No. 122, [AU-C § 930.15](#) (Am. Inst. of Certified Pub. Accountants 2011).

fn 9 See INTERIM AUDITING STANDARDS, [AU § 711](#) (Pub. Co. Accounting Oversight Bd. 2003); CODIFICATION OF STATEMENTS ON AUDITING STANDARDS, Statement on Auditing Standards No. 122, [AU-C § 925](#) (Am. Inst. of Certified Pub. Accountants 2011).

fn 10 See *ABA Statement of Policy*, *supra* note 1, at 9–10 (commentary ¶ 2) (“The internal procedures to be followed by a law firm or law department may vary based on factors such as the scope of the lawyer’s engagement and the complexity and magnitude of the client’s affairs. Such procedures could, but need not, include use of a docket system to record litigation, consultation with lawyers in the firm or department having principal responsibility for the client’s affairs or other procedures which, in light of the cost to the client, are not disproportionate to the anticipated benefit to be derived. Although these procedures may not necessarily identify all matters relevant to the response, the evolution and application of the lawyer’s customary procedures should constitute a reasonable basis for the lawyer’s response.”).

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IAASB Update

Presentation at the July ASB 2022 Meeting

Agenda

General Update

Audits of Less Complex Entities

Sustainability

Fraud

Going Concern

Listed Entities and Public Interest Entities

Audit Evidence



Agenda Item 7

General IAASB Update

Wendy Stevens, Mazars and IAASB Board Member

Key Items



June 2022 IAASB Meeting Highlights



Tom Seidenstein Reappointed as IAASB Chair



PIE exposure draft published July 2022; Going Concern NAG approved



IFAC/IAASB Focus on Technology



Other Activities



IAASB Update: Audits of Less Complex Entities

Horace Emery, ASB Task Force Chair

Executive Summary

The following are the key takeaways* from the June IAASB Meeting:

1	The IAASB agreed that the project to develop a separate standard for audits of LCEs should continue, while acknowledging concerns from respondents that did not support the project (often due to perceived or anticipated market confusion)
2	The IAASB's discussion focused on narrowing the scope of the draft standard and refining the definition/description of a "typical LCE"
3	The IAASB provided direction on how revisions could be made to address respondents' concerns around further differentiating the proposed standard from the ISAs (while still obtaining reasonable assurance) and the sufficiency of Essential Explanatory Material in the proposed standard
4	The IAASB also supported the inclusion of procedures for group audits in the scope of the draft standard and provided direction on the type of group audits that should be in scope and how such requirements may be presented
5	In September 2022, the LCE Task Force plans to bring to the Board for discussion the revised Authority of the draft standard, proposed content and requirements addressing group audits, along with other targeted topics. The IAASB is targeting the 2 nd half of 2023 for issuance of a final standard



Key Matters

Matter	Discussion Highlights
Proposed Description of a “Typical LCE”	<ul style="list-style-type: none">• The IAASB Task Force presented a table outlining the Task Force’s initial thinking on characteristics of a “typical LCE” (see paragraph 63)• The IAASB directed that the Task Force narrow the definition/description of a “typical LCE” as contained in the proposed Authority Document• The IAASB stated that it should be clearer that the standard is intended only for those who are considered “small” (and not medium)• IAASB members leaned toward qualitative over quantitative criteria; others indicate that such criteria could be jurisdictionally developed• Some IAASB members indicated that significant accounting estimates more complex than, for example allowance for doubtful accounts, seemingly should exclude an entity from the propose LCE standard
Standalone Standard for Audits of LCEs	<ul style="list-style-type: none">• Some feedback received that the proposed standard is “too similar” to the ISAs (length, detail)• Important that the standard result in the auditor obtaining reasonable assurance and performing a high-quality audit• Easing of inability to refer to the ISAs as the IAASB made clear that a practitioner could look to the ISAs for additional guidance.
Group Audits	<ul style="list-style-type: none">• The IAASB leaned toward including group audits in the proposed standard• Task Force directed to explore whether component audits could be performed in accordance with the proposed standard



Considerations for the ASB – Recap the ASB’s survey and potential actions

Challenges with Applying U.S. GAAS to LCE Audits	Other Survey Key Takeaways	Current AICPA/ASB Response Actions	Other Potential Actions
<p>61% did not believe that US GAAS is scalable to LCEs</p> <ul style="list-style-type: none">•73% reported that they are reluctant to scale or modify requirements because of peer review•From most to least challenging, respondents identified the following as challenges:<ul style="list-style-type: none">•Requirements to perform RA procedures and gain an understanding of IC•Overly complex requirements that are not applicable to LCEs•Overly detailed requirements•Onerous documentation requirements•Difficulty scaling substantive audit procedures performed in response to assessed RMM	<ul style="list-style-type: none">•75% believe that the cost of an audit exceeds the benefits for LCEs•There was little consensus on the need for a separate standard for audits of LCEs in that 42% stated that a separate standalone standard should be developed, while 37% did not support the development of a separate standalone standard•93% believe additional application material within the auditing standards should be provided regarding scalability of certain requirements to audits of LCEs;•86% believe audit guides or practice aids (outside of the auditing standards) should be provided related to scaling auditing standards to audits of LCEs	<ul style="list-style-type: none">•ASB:<ul style="list-style-type: none">•Risk Assessment Guide for LCEs (2nd half 2022)•Technology Enabled Risk Assessment resource (2nd half 2022)•AICPA<ul style="list-style-type: none">•Dynamic Audit Solution•ARSC<ul style="list-style-type: none">•Enhanced standards for reviews clarifying that a review is an assurance engagement (more closely related to an audit than a compilation)	<ul style="list-style-type: none">•In addition to ISA for LCEs, consider what’s been developed by other NSS/Regulators (e.g., German ED, French statutory framework, initial Nordic Federation draft) for potential guidance for US auditors•Seek additional opportunities to provide input to the IAASB•Address issues raised in our survey•Other?

The ASB’s Audits of LCE TF request the ASB’s views and guidance on what activities, if any, it should perform now to support the IAASB’s ongoing LCE work AND/OR address issues in practice for U.S. auditors



IAASB Update: Reporting on Sustainability and ESG Information

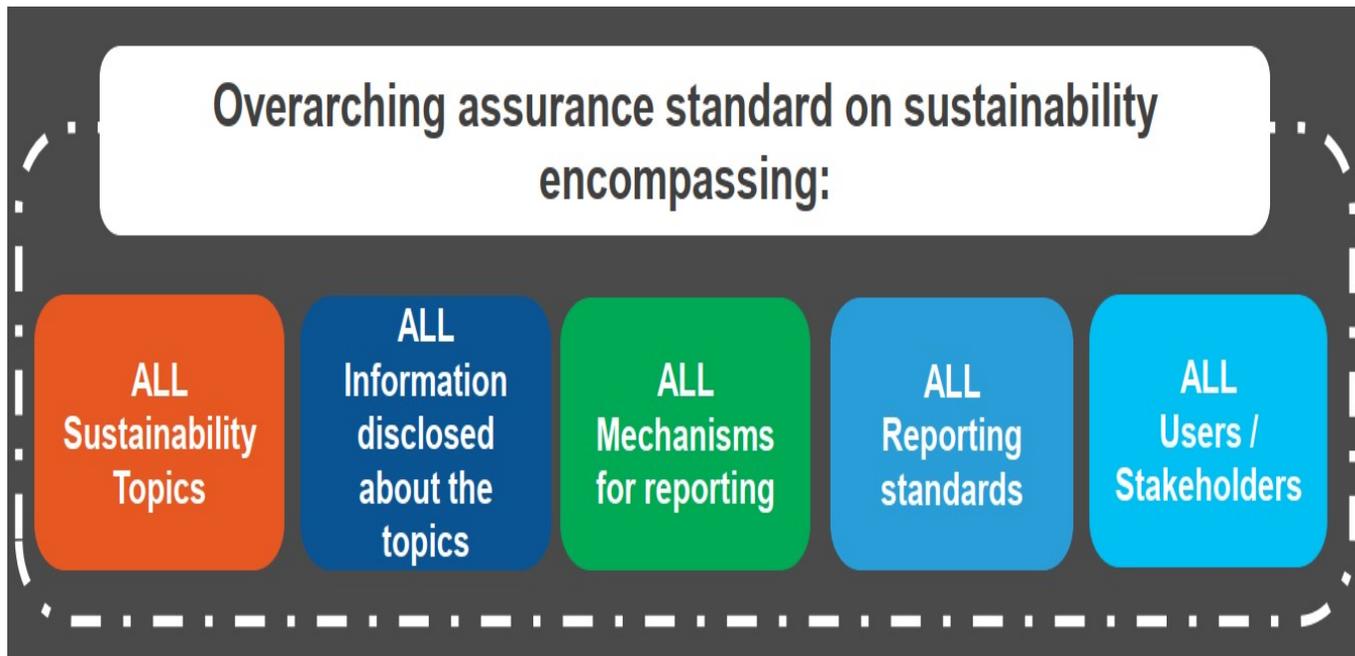
Diane Hardesty, ASB Task Force Chair

Consensus as of the June 2022 IAASB Meeting

- Support the creation of an overarching stand-alone sustainability standard *that is consistent with* ISAE 3000
- Emphasize timely and responsive standard-setting, initiate action immediately
- Develop a “suite of sustainability standards” over time to respond to emerging issues

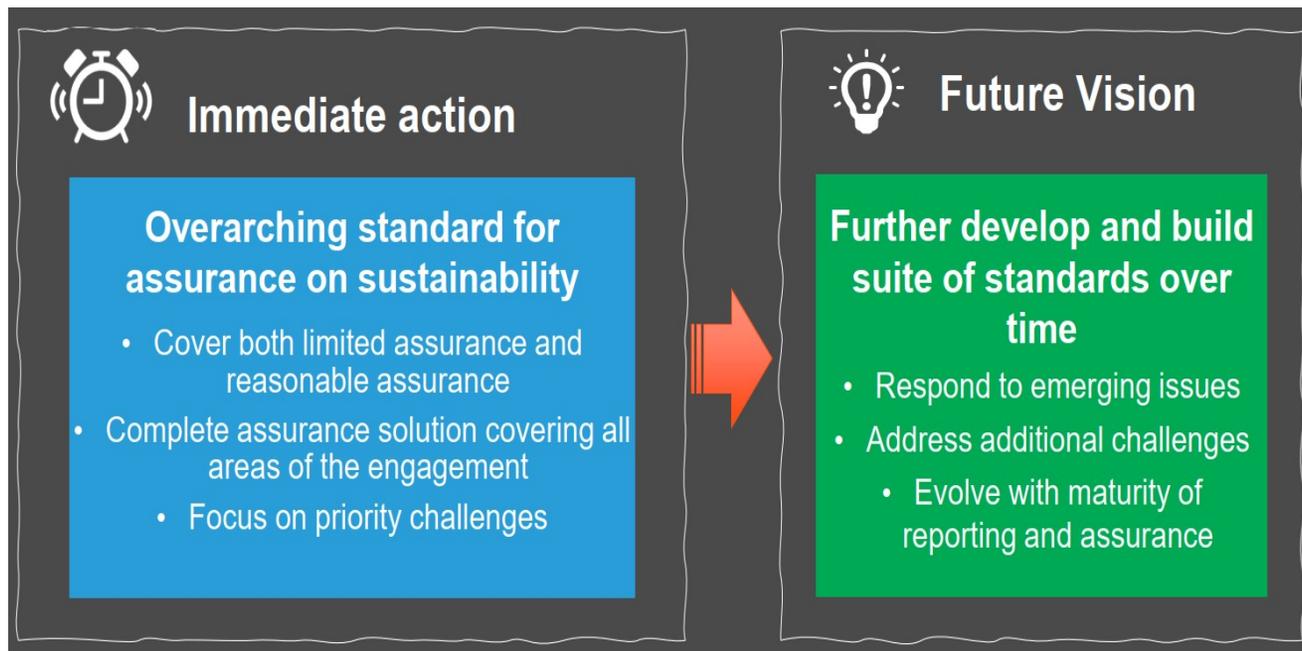
There were several board members that continued to support a “top-up” approach, but the majority supported a stand-alone standard.

Content of the new sustainability standard



- **Topics** include climate, economic impacts, labor practices, human rights and community relations, and biodiversity
- **Information** includes governance, strategy and business model, risks and opportunities, metrics and key performance indicators, targets, internal control over monitoring and managing risk, and impact analysis
- **Mechanisms** for reporting include integrated reports, annual reports, management commentary and sustainability reports
- **Reporting standards** include ISSB, GRI, EU CSRD, SEC, EFRAG
- **Users / Stakeholders** include those focused on enterprise value creation, such as providers of capital and broader stakeholders focused on impacts on economy, environment or society

IAASB Strategy for Developing Assurance Standards on Sustainability



The IAASB envisages that future standard-setting action could be undertaken to further develop a suite of standards to meet emerging priorities as reporting and assurance mature, and address other challenges not included as part of the initial standard-setting effort.

Focus of the Sustainability Assurance Working Group (SAWG)

 Start with ISAE 3000 (Revised), ISAE 3410 and IAASB Guidance on Sustainability / EER

+ Add specificity and enhancements for assurance on sustainability

 More specifically address the following priority challenges:

 Limited versus reasonable assurance	 Suitable reporting criteria	 Scope of engagement	 Evidence	 Internal Controls	 Practitioners' Materiality	 Reporting
---------------------------------------------------------------------------------------------------------------------------	--------------------------------------------------------------------------------------------------------------------	-----------------------------------------------------------------------------------------------------------	-------------------------------------------------------------------------------------------------	----------------------------------------------------------------------------------------------------------	---------------------------------------------------------------------------------------------------------------------	---------------------------------------------------------------------------------------------------

Next Steps for IAASB:

- **September 2022:**
- Draft project plan/proposal
- Provide structure of overarching standard and outline of draft requirements
- **December 2022:**
- Approve project plan/proposal
- Draft requirements and application material
- Discussion of key challenges

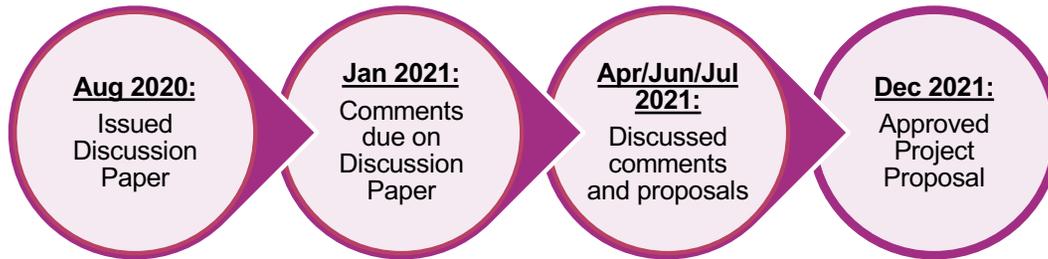
Exposure draft 2nd half of 2023



IAASB Update: Fraud

Tania Sergott, ASB Task Force Chair

IAASB Fraud Project Timeline



ASB will need to consider how best to move forward with an ASB project on fraud – to be considered after the December 2022 IAASB meeting materials become available

Issues discussed - March 2022 IAASB Mtg:

- Risk identification and assessment
- Communication with those charged with governance
- Transparency in the auditor's report
- Non-authoritative guidance

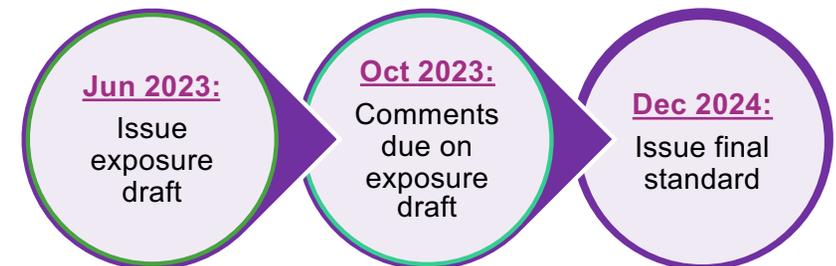
Issues discussed - June 2022 IAASB Mtg:

- Introductory section
- Specialized skills
- Risk assessment
- Understanding the entity & its environment
- Presumed fraud risk – revenue recognition
- Journal entries
- Communication with those charged with governance

Details of June 2022 meeting on next slides

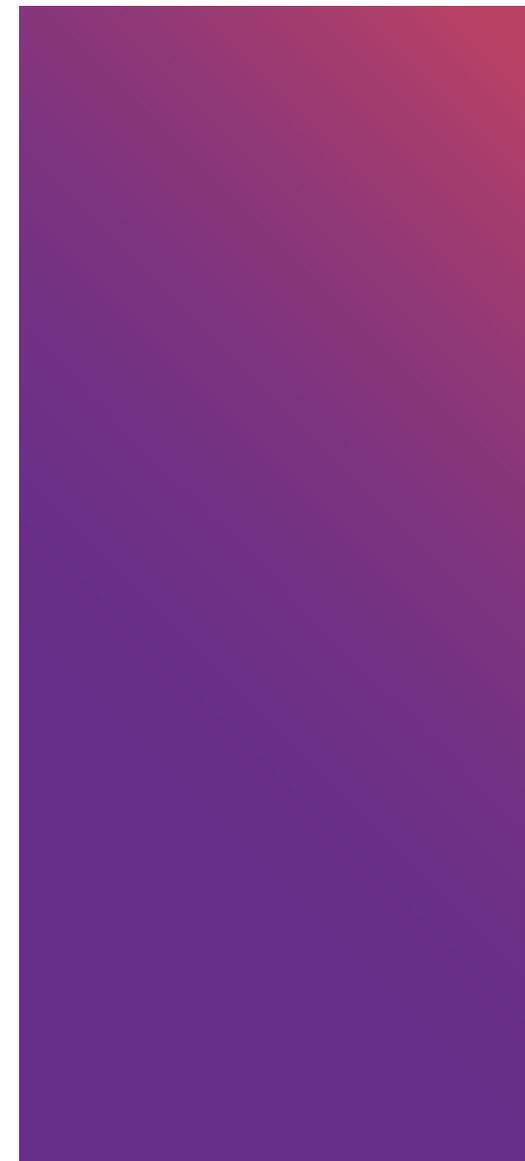
Issues to be discussed - December 2022:

- Definition of fraud
- Written representations
- Technology
- Analytical procedures
- Audit procedures for identified or suspected fraud
- Unpredictability of audit procedures
- Third-party fraud
- Audit documentation
- External confirmation



Fraud - June IAASB Meeting Key Takeaways

Topic	Overview of Key Changes	Key Takeaways from June IAASB Meeting
<p><u>Sections I & II:</u> Structure and Reorder Introduction – Emphasis on Auditor’s Responsibility Regarding Fraud</p>	<ul style="list-style-type: none"> The IAASB is proposing to align the layout and headings of ISA 240 with that of ISA 315 (Revised 2019) The IAASB is proposing to reorganize the introduction section of ISA 240 <ul style="list-style-type: none"> Place auditor’s responsibilities up front followed by management’s responsibilities Create a “Key Concepts” section which includes “characteristics of fraud” Make explicit in the introduction that the auditor is concerned with both fraud or “suspected fraud” Expand on professional skepticism and interplay between ISA 240, ISA 250, and other ISAs <p>Paragraphs 1-9A, A1A-A7 of IAASB agenda item 7A</p>	<p>The IAASB broadly supported the reorganization of the introductory paragraphs to emphasize auditor’s responsibilities relating to fraud and reduce the ambiguity between inherent limitations and auditor’s responsibilities.</p> <p>Different members expressed varying comments regarding including “suspected fraud” in introductory materials and/or definition of fraud. TF was asked to review extant paragraphs to identifying where distinguishing between fraud and suspected fraud would encourage enhanced behavior.</p> <p>The IASTF had concerns about unintended consequences of including “suspected” fraud into every instance of fraud in the standard.</p>
<p><u>Section III:</u> Specialized Skill</p>	<ul style="list-style-type: none"> <u>New Requirement:</u> The IAASB is proposing to add to a requirement that links to ISA 220 to determine use of specialized skills or knowledge to perform procedures to identify and assess risks of material misstatement due to fraud. <ul style="list-style-type: none"> Includes application material about forensic skills <p>Paragraph 16A and paragraphs A12A-A12D of IAASB agenda item 7A</p>	<p>The IAASB provided broad directional support for the proposed changes to the section relating to specialized skills. Some members asked for clarification on specialized skill vs. requirement in ISA 220 for “team with appropriate capabilities” vs. use of an expert.</p> <p>The IASTF had concerns (a) that the use of forensic skills needed better context in the application material (align with project proposal), (b) about triggering a documentation burden for when the auditor did not consider specialized skills were needed.</p>



Fraud - June IAASB Meeting Key Takeaways (2)

Topic	Overview of Key Changes	Key Takeaways from June IAASB Meeting
<p><u>Sections IV and VII:</u> Risk Assessment Procedures and Related Activities</p> <p>Obtaining an Understanding of the Entity</p> <p>Identifying and assessing the ROMM</p>	<ul style="list-style-type: none"> The IAASB worked on better aligning ISA 240 with ISA 315 by including similar structure/sections as ISA 315. This resulted in the IAASB task force findings ways to provide a link to ISA 315 to which the auditor could then apply a fraud lens. IAASB used the phrase “In applying ISA 315 (Revised 2019)” when the auditor is required to do something in addition to the requirements in ISA 315 <p>Paragraph 17-24, 24B, and paragraphs A21E-A23A, A23D-A23L of IAASB agenda item 7A</p>	<p>The IAASB supported revisions to include recent changes in ISA 315 (Revised 2019), however there were mixed views on how to accomplish this. The IAASB emphasized that the risk assessment procedures relating to fraud are intended to expand upon, and should not duplicate, what is already in ISA 315 (Revised 2019) and cautioned against implying that there were two separate risk assessments.</p> <p>The IASTF had similar concerns about the construct and supported expanding upon ISA 315 (Revised 2019) without unnecessary duplication.</p>
<p><u>Section V:</u> Presumption of Fraud Risk in Revenue Recognition</p>	<ul style="list-style-type: none"> The IAASB attempted to shift the focus from developing a rebuttal to performing robust risk identification an assessment <p>Paragraph 27 and paragraphs A28A-A28B, A30A-A31A of IAASB agenda item 7A</p>	<p>The IAASB provided broad directional support for proposed changes relating to presumed fraud risk in revenue recognition.</p> <p>The IASTF did not have concerns with the proposed changes.</p>

Fraud - June IAASB Meeting Key Takeaways (3)

Topic	Overview of Key Changes	Key Takeaways from June IAASB Meeting
<u>Section VI: Journal Entries</u>	<ul style="list-style-type: none"> The IAASB considered enhancing the requirements to clarify that the auditor’s risk assessment procedures in ISA 315 for controls over journal entries are also relevant to the auditor’s decisions on journal entry testing <p>Paragraph 33(a), and paragraphs A42-A45A of IAASB agenda item 7A</p>	<p>The IAASB provided broad directional support for proposed changes relating to journal entries. Some members questioned whether the materials provided sufficient guidance on “how to select which journal entries to test.”</p> <p>The IASTF questioned the usefulness of the proposed changes.</p>
<u>Section VII: Communications with those charged with governance</u>	<p>New Requirement: IAASB added new requirement for specific discussion with those charged with governance about fraud-related matters in the audit to encourage more 2-way communication</p> <ul style="list-style-type: none"> IAASB developed application material to explain the importance of effective 2-way communication <p>Paragraph 40A and paragraphs A60A-A60C of IAASB agenda item 7A</p>	<p>The IAASB supported the proposed changes for enhancing two-way communication with TCWG, including emphasizing the ongoing nature of these communications throughout the audit.</p> <p>The IASTF was also supportive of these changes .</p>
NEXT STEPS	<ul style="list-style-type: none"> September 2022 IAASB Meeting – Update about specific outreach activities with users of the financial statements regarding transparency in reporting (outreach = interviews with ~ 20 users, conducted by TF members in June & July) December 2022 IAASB Meeting – Bring a substantially full draft of the standard Expected June 2023 approval of Exposure Draft by IAASB 	



IAASB Update: Going Concern

Clay Huffman and Laura Schuetze,
ASB Task Force Chairs

Executive Summary

•The following are the key takeaways* from the June IAASB Meeting:

1	The IAASB generally supported the proposed change in the commencement date of the period of the auditor's evaluation of management's assessment of going concern to at least twelve months from the date of approval of the financial statements
2	The IAASB directed the IAASB's Going Concern Task Force to continue exploring proposals and illustrative drafting with respect to providing explicit statements about going concern in the auditor's report
3	The IAASB agreed to move forward with the issuance of the non-authoritative guidance that addresses frequently asked questions about reporting going concern matters in the auditor's report
4	In September 2022, the IAASB's Going Concern Task Force intends to discuss certain other proposed actions in the project proposal such as risk identification and assessment, terminology, management's assessment of going concern, and professional skepticism



Other Matters

- ASB-led work to conduct going concern survey and interviews in-progress:
 - Goal: 100-150 responses per stakeholder group on going concern reporting in the auditor's report
 - Summarized results expected in late August 2022 with feedback to be shared with the IAASB Going Concern Task Force for the IAASB's September 2022 meeting
- Other items:
 - Monitoring other standard setting actions (e.g., PCAOB's Going Concern Project, GASB)
 - Monitoring Peer Review findings on recent AU-C 570 changes

Questions for the ASB

1. Does the ASB generally support the IAASB's tentative decisions?
2. For purposes of convergence planning, should the ASB's Going Concern Task Force start to evaluate now the impact of the IAASB's tentative decisions on AU-C 570, e.g.,
 - a. Whether to change the commencement date of the period of the auditor's evaluation of management's assessment of going concern?
 - b. Whether the auditor should explicitly state that use of the going concern basis of accounting is appropriate when no material uncertainty exists?



IAASB Update: Listed Entities and Public Interest Entities

Andrew Prather, ASB Task Force Chair

Executive Summary

On June 17, the IAASB approved a narrow scope ED that would amend ISA 700 (revised) and ISA 260 (revised)

- The ED was released on July 6, 2022, with a 90-day comment period (ending October 4, 2022)
- The core focus of the ED is the conditional requirement and accompanying illustrations to publicly disclosed that differential independence requirements for audits of financial statements of certain entities (including public interest entities) were applied
- While IESBA's transparency requirement would apply to review engagements, the IAASB decided to not propose ISRE 2410 amendments as part of the current LE/PIE project

The ED proposes application material focused on:

- Relevant ethical requirements (RER) that may also require or encourage the auditor to determine whether it is appropriate to apply the differential independence requirements for the audits of certain entities not specified in the RER
- Confidentiality provision in the RER that may prohibit the auditor from such disclosure
- Increased transparency with TCWG that differential independence requirements for certain entities have been applied

In December 2022, the IAASB is expected to discuss "track 2" matters including

- Whether the IAASB should adopt the IESBA definitions of "publicly traded entity" and PIE
- What should be the objective and guidelines for establishing differential requirements for certain entities in the ISQMs and ISAs; and
- Which entities the extant differential requirements for listed entities in the ISQMs and ISAs should apply to, using a case-by-case approach, and consequential considerations for the application and introductory material in these standards

Key Decisions Needed by PEEC and ASB

Key:	Blue box = PEEC Action
	Maroon box = ASB Action
	Red box = Urgent
	Yellow box = Caution

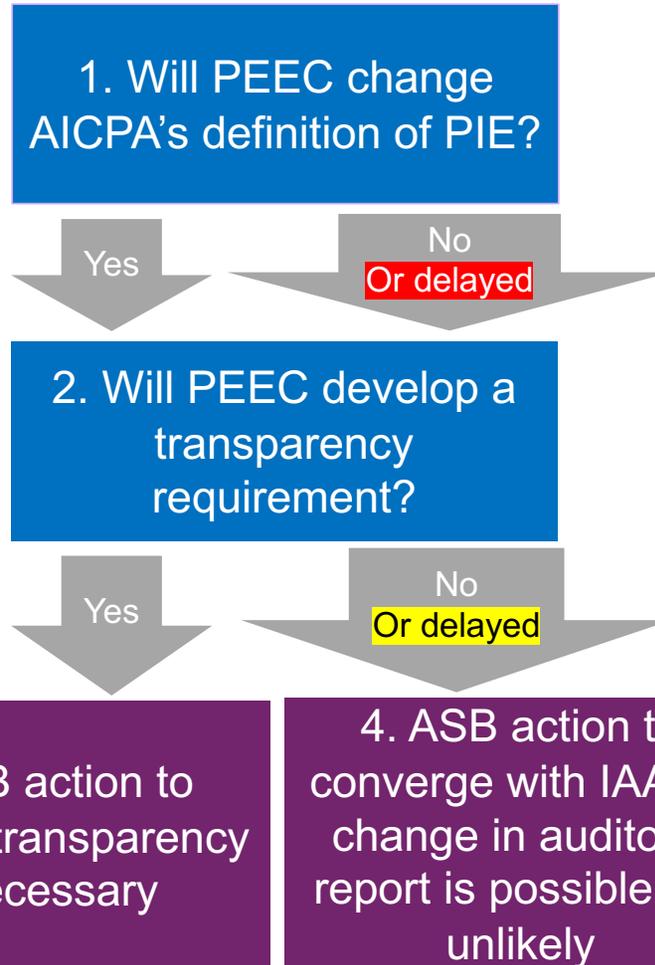
IESBA's PIE Definition: A firm shall treat an entity as a public interest entity when it falls within any of the following categories:

- a) A publicly traded entity;
- b) An entity one of whose main functions is to take deposits from the public;
- c) An entity one of whose main functions is to provide insurance to the public; or
- d) An entity specified as such by law, regulation or professional standards to meet the purpose described in 400.10.

IESBA Transparency Requirements:

Audit firms must explicitly disclose whether the firm has applied the applicable independence requirement under the relevant ethical framework

IAASB Requirements: TBD



AICPA PIE Definition: All of the following:
 a) All listed entities, including entities that are outside the United States whose shares, stock, or debt are quoted or listed on a recognized stock exchange or marketed under the regulations of a recognized stock exchange or other equivalent body.
 b) Any entity for which an audit is required by regulation or legislation to be conducted in compliance with the same *independence* requirements that apply to an audit of listed entities (for example, requirements of the SEC, the PCAOB, or other similar regulators or standard setters).

AICPA Transparency Requirements:

Ethics Code: TBD

AU-C Section 700 para .28c and A39 state:

- The report is required to include a statement that the auditor is required to be independent of the entity and to meet the auditor's other ethical responsibilities, in accordance with the relevant ethical requirements relating to the audit.
- When independence and other relevant requirements are contained in a limited number of sources, the auditor may choose to name the relevant sources.

Other Matters



ASB-PEEC Coordination Update

- PEEC TF Convergence Status
- August 3, 2022 PEEC Meeting w/ recommendations



Expected Direction of ASB Comment Letter

- Overall supportive
- Concern that financial statement users may interpret that non-PIEs have lesser quality of assurance
- Encourage creation of education materials to prevent expectation gap
- ASB to receive CL draft by early September



Questions for the ASB

1. Do you have any feedback regarding the direction of the comment letter?
2. Do you have any suggestions for our on-going interaction with PEEC?



IAASB Update: Audit Evidence

Kathy Healy, ASB Task Force Chair

Key Takeaways

- IAASB broadly supportive of revised draft, which includes a separate requirement to obtain audit evidence about accuracy and completeness of information intended to be used as audit evidence when those attributes are applicable
- Although IAASB Staff and TF believe they have taken SAS 142 into account, ASB TF remains concerned that the revised ISA may not be substantially the same
 - Further analysis needed to enable the ASB to conclude on the nature and extent of differences and impact on convergence
- ASB has the benefit of having a separate Data Analytics guide to provide additional details about how ADAs are used in performing procedures / obtaining evidence
 - Opportunities for the IAASB to embed current practices into the standard to promote greater use of technology in light of the objectives of the project

How ASB recommendations have been addressed to date

Recommendations taken:

- Inclusion of the phrase “used by the auditor” in the definition of *audit evidence*.

Recommendation addressed by other revisions:

- Additional application material to supplement the definition of *audit evidence*, based on paragraphs A5 - A6 of AU-C Section 500. IAASB added other AM that we believe is sufficient.
- The proposed ISA 500 (Revised) link to paragraph 8 of ISA 230, *Audit Documentation*. IAASB revised par. A56 of proposed ISA with better language.

Recommendations not taken:

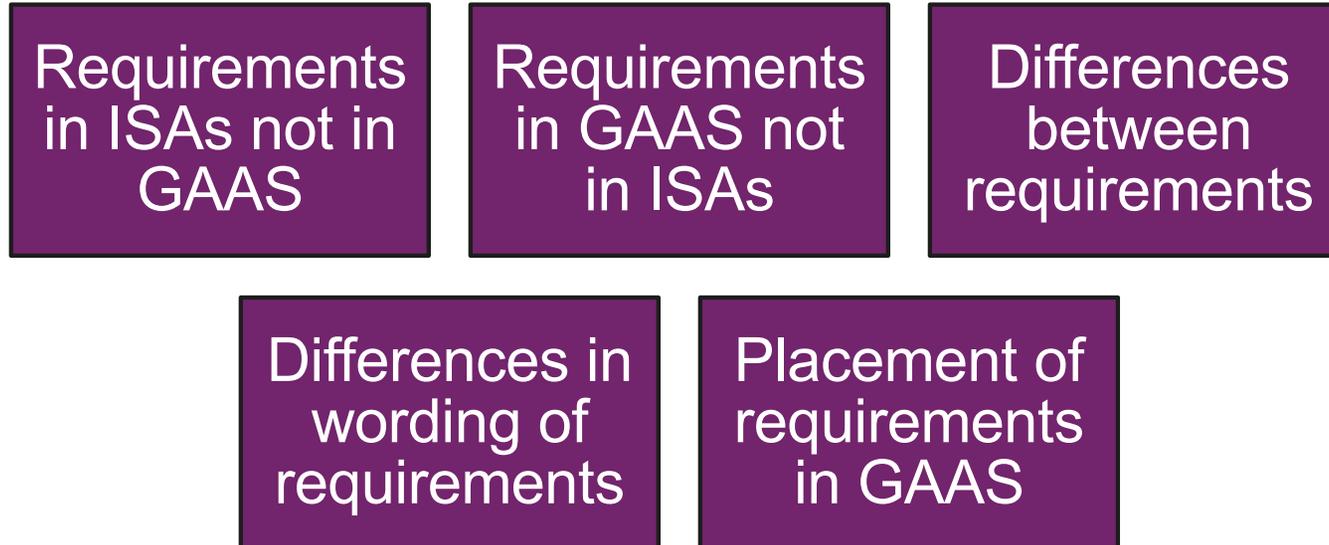
- Inclusion of the concepts of relevance and reliability in the definition of *appropriateness (of audit evidence)*.
- Proposed revisions to paragraph 10 addressing management’s experts. We repeated this comment in June.
- Addition of examples of under-reliance on technology were provided. IAASB Task Force did not address.

Continuing concerns:

- Difference in wording of objective and certain requirements
- Documentation requirements
- Plans to develop non-authoritative guidance

Framework to Evaluate Substantive Differences

The ASB's task force proposes applying an "Appendix B" approach to more fully understand meaningful differences between the proposed ISA 500 revisions and issued but not yet effective SAS 142 standard to inform the ASB's approach to convergence



- Are there other criteria that the ASB believes that the ASB's TF should consider in evaluating the IAASB's proposals?

Next Steps

- Discussions with IAASB TF staff by August
 - Focusing on incremental guidance proposed by ASB TF, including greater emphasis on using technology
- Influence the IAASB's planned ED vote in September
- Document and prepare an initial Appendix B analysis for the ASB meeting in October 2022
- Respond to the ED in an ASB comment letter (likely due January 2023)





Worldwide leaders in public and management accounting

Emerging Technologies

Diana Krupica, AICPA Assurance and
Advisory Innovation

Presentation at the July ASB 2022 Meeting

Overall summary

- **Blockchain background**
 - Layers and aspects of software systems
 - What is blockchain?
 - How do blockchains maintain security?
 - Blockchain use cases
- **Digital assets background**
 - Types of digital assets
 - Uses of digital asset
 - Storage and access
 - Challenges accounting and auditing

ASEC efforts in areas of technology:

- Digital assets practice aid, glossary, learning
- Proof of reserves development of criteria, potential need for continuous auditing
- Blockchain white paper and learning
- AI white papers and learning, data integrity criteria

Blockchain background

Layers and aspects of software systems

Application layer: user needs

Implementation layer: making things happen

Functional aspects: what is done

Nonfunctional aspects: how things are done

- Users focus on functional aspect/ application layer (taking picture/making phone call/texting)
- Nonfunctional aspect of implementation layer less visible to users (store data efficiently)
- Integrity important nonfunctional aspect
- Blockchain part of implementation layer and ensures integrity of nonfunctional aspect

What is blockchain?

- Distributed ledger where transactions are recorded/confirmed in a trustless manner
- Record of events that is shared and updated in real-time, between all participants (nodes)
- It is an append-only database, once data is recorded, it cannot be altered
- No trusted central authority

Types of Blockchains

Public
(permissionless)

Private
(permissioned)

Hybrid
(public/private)

How do blockchains maintain security?

- Consensus mechanisms
 - Many different types
 - Dictates the rules transactions must follow to be approved by nodes on the network
 - Dictates how transactions flow between nodes and are approved by nodes on the network
 - Ensures next block in a blockchain is the single source of truth

Consensus mechanisms:

- Proof of Work (Bitcoin blockchain)
- Proof of State (Ethereum blockchain: transfer in process)

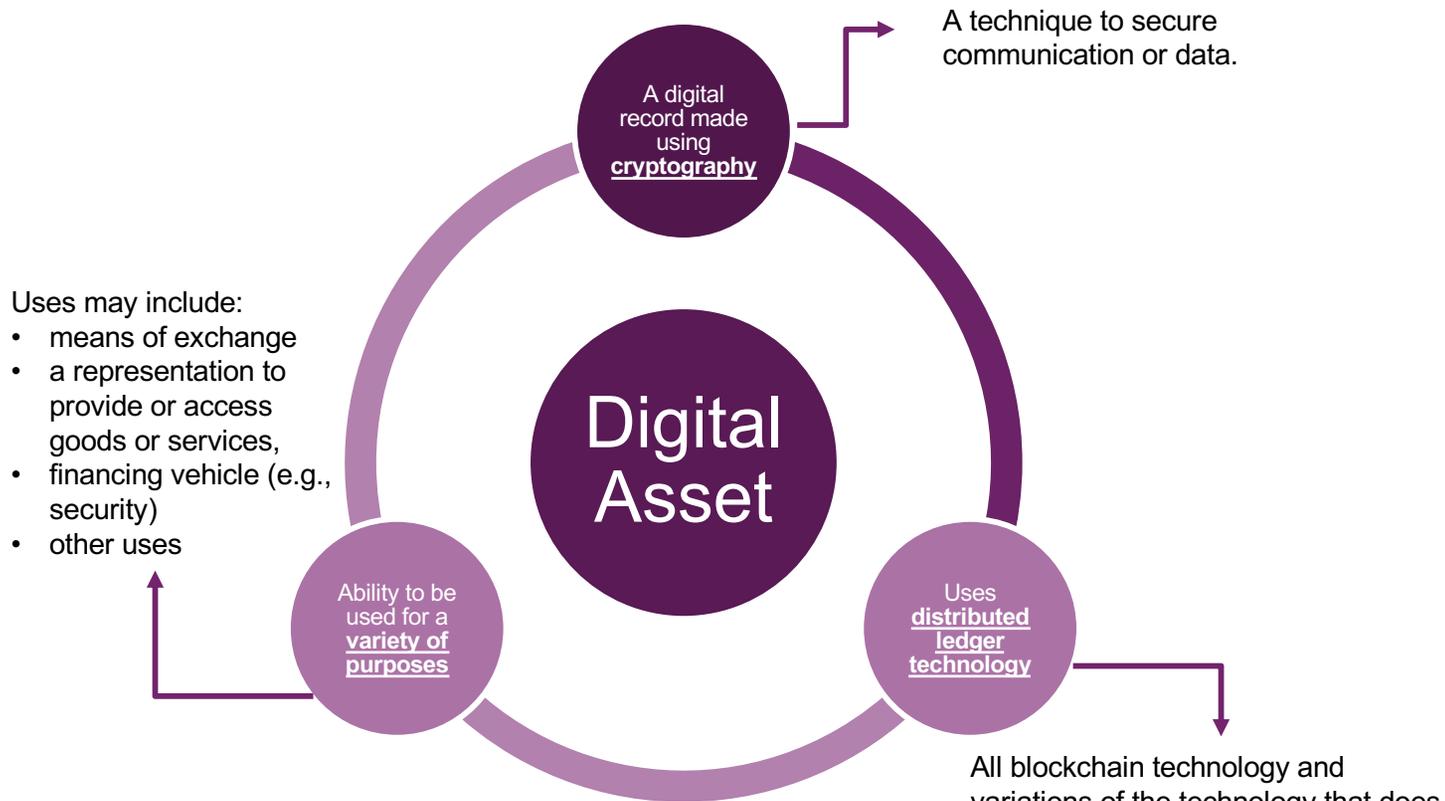
Blockchain use cases

- Secure sharing of medical data
- Music royalty tracking
- Supply chain and logistics monitoring
- Real estate processing
- Voting mechanisms
- Digital asset transactions



Digital assets background

What is a digital asset?



Types of digital assets

- Crypto assets (bitcoin, ether)
- Stablecoins
 - Fiat backed
 - Crypto backed
 - Commodity backed
 - Algorithmic (noncollateralized)
- Central-banked digital currencies (CBDCs)
- Non-fungible tokens
- Other tokens (security/utility)

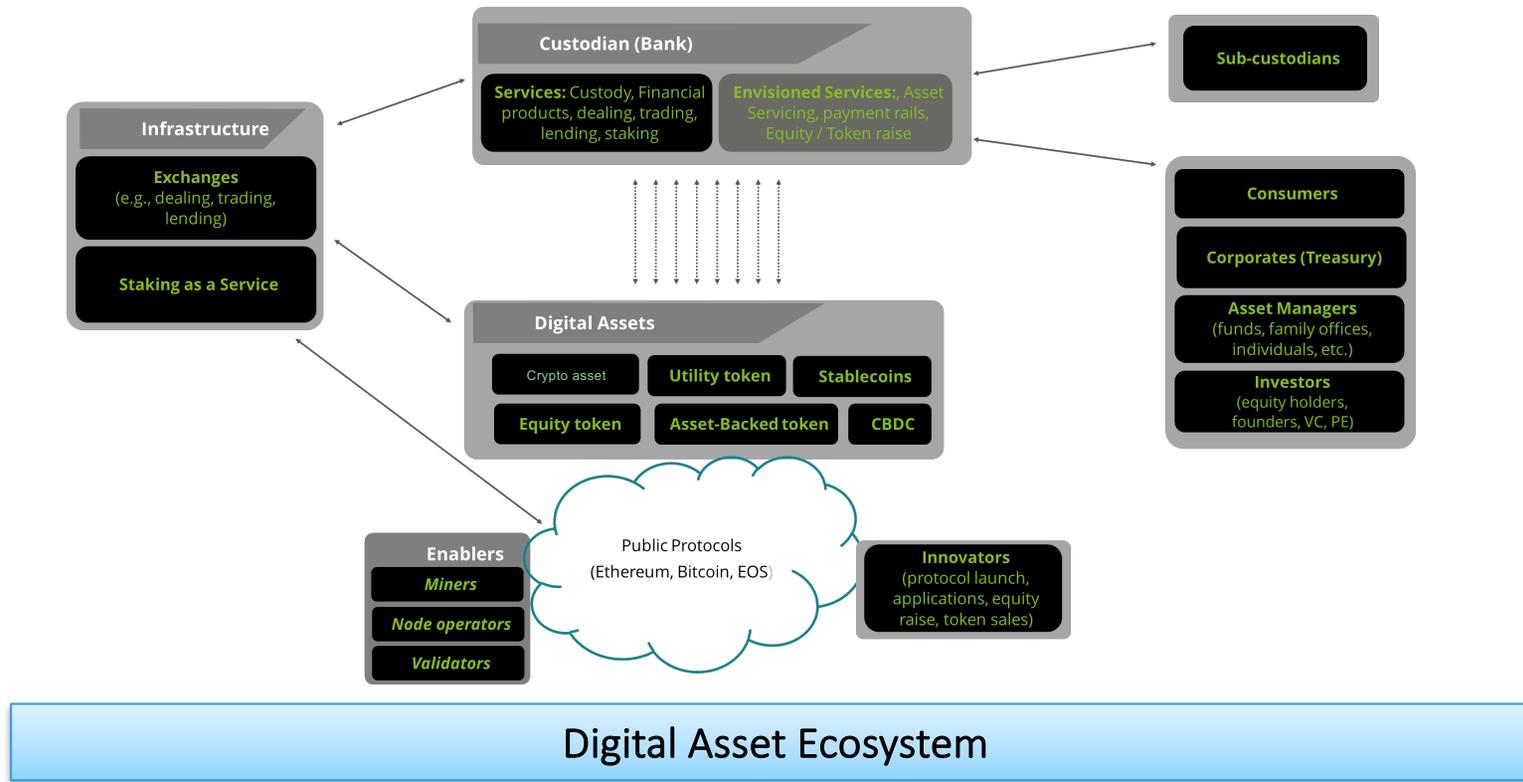


Uses of digital assets

- Purchase
- Sale
- Investment
 - Long-term holding
 - Decentralized finance (such as, loaning out digital asset)
 - Staking
- Trade
 - Buying and selling based on current market price
- Exchange
 - Buying and selling based on an agreed upon price not necessarily the current market price



Who participates or is involved with digital assets?



Storage and access

- Digital wallet creates and stores public/private key of a wallet address on a blockchain
- Public keys create public address that allows anyone to view a wallet's transactions and balances
- Private keys are used to digitally sign transactions
- Only private keys can be used to send funds out of a wallet address
- Control of a digital asset is based on the access to a private key

Challenges accounting and auditing

- Digital asset markets differ from traditional because markets never close and may span multiple time zones
- Complexity of the private key security and gaining comfort about who has access and who controls the private keys
- Overall complexity of the financial reporting system increases (blockchain interfacing with traditional financial systems)
- Entities holding digital assets in custody for customers often pool customer digital assets into consolidated addresses (commingling)
- Pseudo-anonymous nature of blockchain makes it difficult to identify related parties

Digital assets are transforming the underlying infrastructure and platforms of nearly all commercial activities

 **Decentralized crypto assets**
e.g., BTC, ETH

 **Algo-driven autonomous algorithm executing transactions**
e.g., Metronom

 **General asset backed**
e.g., Tether

 **Digital representations of fiat currency** e.g., USDC, GUSD

 **Utility tokens**
e.g., ZRX, BAT

 **Specific asset backed**
Gold, diamonds, precious metals, real property

 **DeFi/Exchange tokens**
e.g., Uniswap, Chainlink, Binance

 **NFTs**
e.g., Bepple, NBA Top Shots

 **Equity tokens**
Digital representation of equity

 **Security tokens**
Expected return; debt instrument

 **Derivative tokens**
Oil rights; derivative of traditional security or digital asset

 **China Yuan**

 **Russia Ruble**

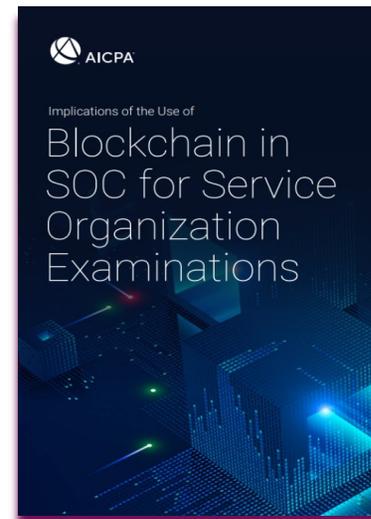
 **USA Digital Dollar**

Appendix

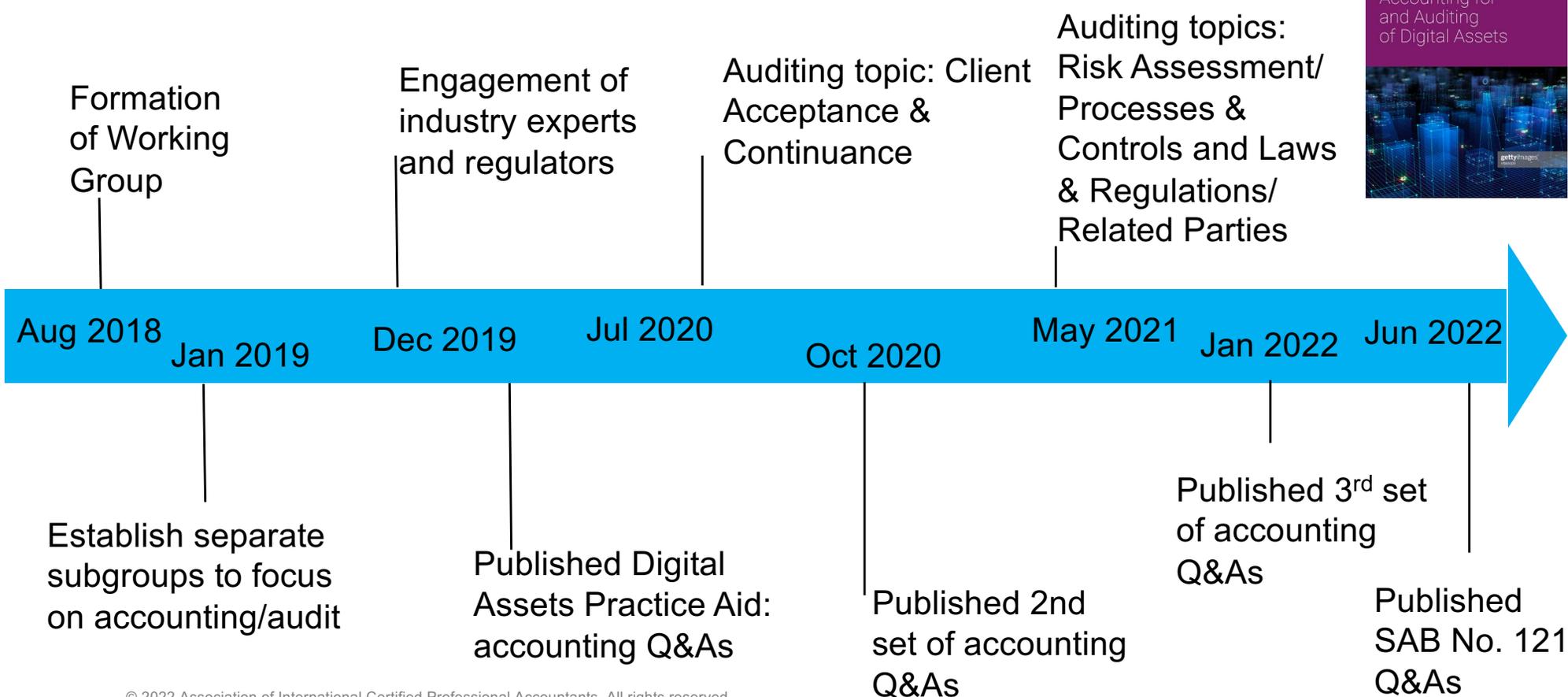
ASEC efforts in area of blockchain technology

Blockchain resources

- White papers
 - Blockchain Risk: Considerations for professionals (joint with ISACA)
 - Implications of the use of blockchain in SOC for service organization examination
- Annual blockchain symposium
- Blockchain certificate program
- Universal blockchain glossary

The cover is purple with the AICPA & CIMA logo at the top left and the title 'Blockchain Universal Glossary' in white text.
The cover is blue and white. It features the COSO logo at the top, the title 'BLOCKCHAIN AND INTERNAL CONTROL' in the center, and 'THE COSO PERSPECTIVE' below it. It is sponsored by Deloitte.
The cover is white with a black curved border on the left. It features the title 'Blockchain Risk Considerations for Professionals' and a graphic of a grid of blue and green circular icons at the bottom.

Developing of digital assets guidance



AICPA Digital Assets Working Group

Accounting Subgroup		Auditing Subgroup	
Matthew Schell, <i>Chair</i> Crowe LLP	Jin Koo BDO USA LLP	Amy Steele, <i>Chair</i> Deloitte & Touche LLP	Shelby Murphy Deloitte & Touche LLP
Michael Bingham US Government Accountability Office	Corey McLaughlin Cohen & Company	Michael Bingham US Government Accountability Office	Mark Murray RSM US LLP
Monique Cole RSM US LLP	Scott Muir KPMG LLP	Damon Busse Baker Tilly US, LLP	Rich Perilloux Crowe LLP
Geoff Griffin Ernst & Young LLP	Amy Park Deloitte & Touche LLP	Mary Grace Davenport PwC	Christian Randall Cohen & Company
Rahul Gupta Grant Thornton LLP	Beth Paul PwC	Michael Gonzales Ernst & Young LLP	Kristen Schrader PwC
Kevin Jackson PwC	Aleks Zabreyko Connor Group	Jeremy Goss FORVIS	Jay Schulman RSM US LLP
Dan Noll, AICPA	Taylor Harris, CAQ	Michael Kornstein Ernst & Young LLP	Kyle Sewell BDO USA LLP
		Sara Krople Crowe LLP	Robert Sledge KPMG LLP
		Han Lee Grant Thornton LLP	Jagruti Solanki BitPay
		Bryan Martin BDO USA LLP	Markus Veith Grant Thornton LLP
		Dylan McDermott Coinbase	Jodie Yan KPMG LLP
		Ami Beers, AICPA	Amy Pawlicki, AICPA
		Ahava Goldman, AICPA	Taylor Harris, CAQ
Di Krupica, AICPA			

Proof of reserves working group

- Divergence in practice for procedures performed/reports issued
- Need identified for consistent set of criteria against which information can be measured/evaluated
- Organized working group made up of various professionals (practitioners, industry experts, business professionals)
- Determined overall mission:
 - Address needs of those performing various engagements
 - Meet needs of stakeholders

Proof of Reserves

A term of art within the digital asset space that describes the means through which an entity (platform operator) proves to a counterparty (or other stakeholder) that they control digital assets sufficient to cover outstanding liabilities (digital assets held on behalf of others)

Proof of reserves working group (continued)

- Develop framework for assurance needs for fiat backed stablecoins
- Identified need for transparency by stakeholders (regulators, issuers, liability holders, management)
- Initial content to be developed includes:
 - Set of criteria specific to fiat backed stablecoins (exposed for public comment)
 - Application guidance for attestation engagements (procedures to be performed)
 - Illustrative assertions and reports

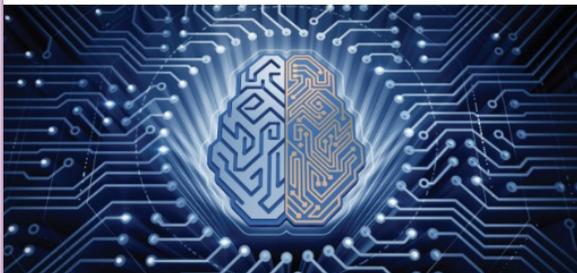
AICPA Proof of Reserves Working Group

Accounting Subgroup	
Jay Schulman, <i>Chair</i> RSM US LLP	Burak Karvan KPMG LLP
Steve Baum Friedman	Han Lee Grant Thornton LLP
Michael Bingham US Government Accountability Office	Jeff Maffitt Baker Tilly
Noah Buxton Armanino	Shelby Murphy Deloitte & Touche LLP
William Coleman Cohen & Company	Jeremy Nau Armanino
Colleen Crowley PwC	Kyle Owens Crowe LLP
Michael Gonzales Ernst & Young LLP	Matthew Schell Crowe LLP
Bob Graham Friedman	Yoland Sinclair Deloitte & Touche LLP
Christian Hinder Cohen & Company	Jeff Trent PwC
Di Krupica, AICPA	Bernie Wieger KPMG
Ami Beers, AICPA	Mike Glenn, AICPA

Other ASEC technology projects

Artificial intelligence white papers

A CPA's Introduction to AI: From Algorithms to Deep Learning, What You Need to Know



The Data-Driven Audit: How Automation and AI are Changing the Audit and the Role of the Auditor



- Co-branded with CPA Canada
- Introduction - AI terms and concepts
- Data-Driven Audit
 - Explores benefits of AI-enabled audit and how AI will evolve the audit and role of auditor
 - Appendix: illustrates implementing automation, analytics and AI across each phase of the audit

Data integrity criteria and backgrounder



To access the criteria and backgrounder click [here](#).

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- ASEC developed:
 - Criteria for describing set of data and evaluating its integrity
 - Backgrounder: Illustrative use cases for how to use criteria for decision making purposes
- Objective of the criteria:
 - Improve quality of disclosures (i.e., definition) about sets of data to reduce risk of misinterpretation or misuse, as well as provide confidence that a set of data is consistent with its definition
- Criteria used to:
 - Prepare a disclosure (i.e., definition) of a set of data
 - Evaluate whether definition presents a set of data in accordance with criteria



Agenda Items 10 & 11

Technology-Related Discussions:

1. ASB Technology Working Group and Blockchain Education
2. ASB and ASEC Virtual Meeting

Presentation at the July ASB 2022 Meeting

ASB Technology Working Group

ASB's Technology Working Group (TWG)

- Chaired by ASB member Samantha Bowling
- Includes other ASB members Kathy Healy, Chris Rogers, and Bob Harris
- Other members: Dan Balla, Margaret Christ, Sara Watson, Erin Mackler, and former ASB member Brad Ames
- Staffed by Brian Wilson
- Note: TWG represents firms of various sizes, preparers, academics, and internal audit



What do we mean by Technology and the Audit?

From the ASB's Strategic 2021-2025 Strategic Plan

- Advancements in, and use of, technology in the audit
- Rapid developments in technologies are having a profound effect on audit and assurance engagements, including the use of automated tools and techniques and changes in how engagement teams are structured and interact
- The increasing use of new and innovative technologies by companies, and by practitioners in performing engagements, has increased the need for the ASB to monitor the development and use of such technologies, including the shift to remote work, and consider whether our standards remain fit for purpose in supporting their use.
- In addition, new and emerging service offerings by firms create the need for the ASB to evaluate whether appropriate standards and guidance are in place for the acceptance and performance of these services

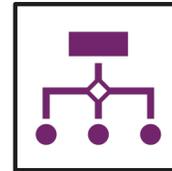
Technology Working Group Objectives



Continuously evaluate technology's effect on the audit and attestation process and timely respond with appropriate standards or guidance



Innovate through technology and enhance audit quality through awareness and education (JOA, Blogs, Seminars, etc.)



Work with Assurance Services Executive Committee (ASEC), the International Auditing and Assurance Standards Board (IAASB) and others to identify and monitor relevant technology trends

The objectives of the TWG, are based on the technology-related initiatives and actions in the ASB's 2021-2025 Strategic plan

The TWG believes that it should be the primary means to educate the ASB and support the ASB's efforts to innovate audit and assurance services through technology

Blockchain Education

Blockchain Education

- Delivered by Di Krupica
- Refer to separate slide deck
- Background resources (for reference only)

ASB Technology Working Group (resume)

Recent Activities

- Developing a technology-enabled risk assessment resource to illustrate how technology and audit data analytics can be leveraged in performing risk assessment procedures in accordance with SAS 145
- Promoting technology adoption for small to medium size firms:
 - JoA articles
 - Embracing Technology in the Audit (February 2022)
 - Artificial Intelligence is a Game Change for Audits (~Sept 2022)
 - Podcasts (Audit Evolution: Jen Burns and Sue Coffey)
 - June 2022 Engage conference (Samantha Bowling and Sara Lord)
- Developing a technology relationship matrix to capture important organizations impacting technology and the audit



Proposed Near-Term Resources*

Focus: Develop resources to resolve issues in-practice and to promote technology

< 12 months

> 12 months

1. Technology-related risk assessment nonauthoritative resource (in-progress)
2. Nonauthoritative guidance clarifying
 - that an audit procedure can be classified into more than one of the categories simultaneously, and/or have more than one purpose, and that a properly designed ADA may simultaneously identify and address a risk of material misstatements. This could be included in an update to the AICPA Non-authoritative Guide to Audit Data Analytics.
 - that an audit procedure performed at the individual item level could meet the classification of a test of details based on its level of precision, and/or the audit procedure classifications are not an all-inclusive list
3. Nonauthoritative guidance that there is a spectrum of risk to be considered when assessing data reliability and for applying auditor judgment
4. Nonauthoritative guidance to publicize the ADA guide and explain some of the key principles set out in SAS 142 (and SAS 145 on risk assessment, SAS 146 and SQMS 1 on technological resources)
5. Issue a resource to clarify the issues around inconsistency use and definitions of certain foundational technology/ADA terms

1. If auditor is using AI to support the audit, how to explain the appropriateness of the audit evidence
2. If the client is using AI, how to audit the “blackbox” of AI
3. Guidance regarding the auditor’s responsibilities with respect to the resolution of items with attributes that differ from those expected (i.e., notable items or possible misstatements) when using ADAs
4. Create more nonauthoritative examples on using Audit Data Analytics (format and/or location – TBD)

Key Questions for the ASB w/ TWG Recommendations

1. Does the ASB believe that U.S. GAAS is generally compatible with using technology (and ADA) but it needs clarity of how technology (and ADA) can be applied to existing standards? If the answer is no, why?

- The TWG believes that U.S. GAAS sufficiently permits or does not prohibit the use of technology and audit data analytics. Some newer standards (e.g., SAS 145, 142) contemplate them. More technology updates to standards have a diminishing return given technological and digital obsolescence
- As a result, the TWG believes that it should use all forms of nonauthoritative guidance and education resources to promote and clarify the use of technology in the audit. See prior slide on short-term priorities

2. Does the ASB believe that CPEA, Peer Review, Audit and Software/Methodology providers should be surveyed to identify what are the impediments to SMP firms using technology? Who are we missing?

- The TWG proposes surveying various groups to determine what is impeding the use of technology among SMP firms by leveraging our current and evolving understanding of the technology provider/disrupter ecosystem impacting the audit

3. Does the ASB believe that the proposed near-term resource projects are where the TWG should spend time and effort?

- The TWG believes it's near-term project focus should be to carve out a lane of work that doesn't duplicate the efforts of others. The TWG's focus should be on getting primarily SMP firms to use technology in Audits, educate them on the risk of using and not using technology and help them determine what audit evidence is with respect to the technology being used
- If the ASB agrees, the TWG will develop a more refined road map on planned actions

ASB and ASEC Virtual Meeting

Agenda

-
1. ASB Technology Working Group Overview (slides 3-5)
 2. Review Near-Term ASB Resource Projects (slides 9-10)
 3. Key Questions for the ASB and ASEC
 4. Background resources (reference only)
-



Key Questions for Joint Discussion

1. Based on a review of the ASB's TWG project list, are there any projects that should be added?
2. Which projects can the ASB and the ASEC collaborate on?

Appendix

ASB Technology-Related Risk Assessment Resource

What is it?

- Intended to be a series of online releases (e.g., through the JoA) that illustrates how technology and audit data analytics can be leveraged in performing risk assessment procedures in accordance with SAS 145 throughout the audit life cycle

The need for a resource

- Primarily for auditors but also management and TCWG
- It is intended to illustrate the nature and impact of the relationship between ICFR (including the maturity and sophistication of management's information systems, data management and technology), and the rate of technology and audit data analytics used in the performance of the auditor's risk assessment under SAS 145

The expected use of the resource

- The resource is nonauthoritative and intended to supplement and not supplant authoritative guidance issued by standard-setters or regulators
- An auditor can determine which elements of the resource might be relevant and scale such elements to address specific facts and circumstances in the audit

Expected Audit Quality Benefits

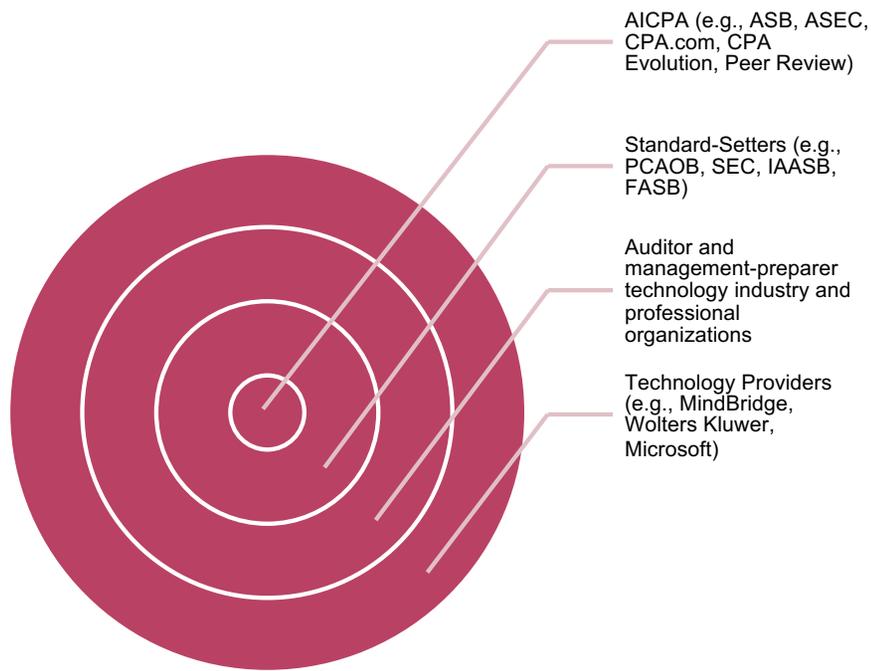
- For auditors:
 - Accelerating investments in automated tools and technology and accelerating the rate of integrating data analytics in their risk assessments and responses to risk enhances AQ
 - Technology-enabled audit data analytics can also enhance interactions with management and those charged with governance who expect high quality, compliant and insight-driven audit work
- For management and TCWG:
 - The greater management's involvement and the more an entity invests to progressively advance its use of technology and increase its sophistication of systems and data, the greater the dimensions of audit quality benefits

Planned deployment

- Three-part release
 - Part 1: Management technology and related controls maturity/capabilities spectrum
 - Part 2: The Auditor's use of technology to scale Risk Assessment procedures
 - Part 3: Illustrative fact patterns or case study
- Part 1 planned for 2nd half of 2022
- Parts 2 and 3 by the 1st half of 2023

DRAFT: pending ASB discussion

Technology-Related Relationship Matrix v1.0



- Purpose: Relationship matrix to capture important organizations impacting technology and the audit (enablers and disrupters). Understand the work being done but also where no work or education is occurring
- Intended Use: Monitor the financial statement audit ecosystem of technology advancement and disruption and plan longer-term TWG projects
- Status: 1st draft in-process

ASB Questions:

1. How does the ASB see it's role among technology-related stakeholders impacting the audit?
2. Who are stakeholders to the ASB when it comes to technology?
3. How could a relationship matrix inform the ASB's annual agenda?

ASEC Projects Summary By Topic – 2nd Quarter 2022 (1)

Topics	Short Term Project	Long Term Project
Blockchain	<ul style="list-style-type: none"> • Implications of blockchain on SOC 1 and 2 • Mapping of ISACA blockchain controls to TSC 	<ul style="list-style-type: none"> • Thought leadership series on blockchain
Digital Assets	<ul style="list-style-type: none"> • Digital assets nonauthoritative guidance topics: <ul style="list-style-type: none"> ○ SAB No. 121 Q&As ○ SOC Considerations (user auditor perspective) ○ ERO assertion Q&As (first wave, other waves to follow) ○ Valuation assertion Q&As ○ Crypto lending/borrowing Q&As • Proof of Reserves (PoR) Engagements: <ul style="list-style-type: none"> ○ Development of suitable criteria for fiat backed stablecoins ○ Development of an overall framework ○ Identifying risks and procedures to be performed 	<ul style="list-style-type: none"> • Potential digital assets nonauthoritative guidance topics: <ul style="list-style-type: none"> ○ Double accounting; Completeness; IT Risks; Hard forks; Presentation and Disclosure

ASEC Projects Summary By Topic – 2nd Quarter 2022 (2)

Topics	Short Term Project	Long Term Project
SOC	<ul style="list-style-type: none"> • Standing up in January 2022 a new cyber squad to promote new Association strategy initiative to promote CPAs in performing attestation and advisory cybersecurity services and SOC reports globally. in connection with the new strategy, staff is developing a couple of thought leadership papers for investors, analysts, regulators and other third parties to help them better understand how a CPA's SOC 2 report can provide decision-useful information about the effectiveness of an organization's security efforts. (Expected 2022; however, the project is in process) • How to Start a SOC Practice toolkit (in process; Expected to be ready for courtesy ASEC review in July 2022 with completion later in Q3.) • Revising SOC 2 guide for revised attestation standards and to continue to evolve SOC 2 examinations to make them more efficient and effective. (Expected completion Q3 2022) • Updating SOC for SC and SOC for Cyber guide for revised Attest Standards • Mapping of revised Cloud Security Alliance (CSA) criteria to TSC (in process) and developing a new SOC 2+ CSA illustrative report • Mapping of TSC to ISACA controls (in process) • Mapping of TSC to revised NIST 800-53 (in process) • Mapping of TSC to NIST 800-171 (in process) 	

ASEC Projects Summary By Topic – 2nd Quarter 2022 (3)

Topics	Short Term Project	Long Term Project
Software Functionality	<ul style="list-style-type: none"> Continuing to discuss market needs for services around the functionality of software, with a focus on smart contracts Developing AUP guidance for providing services and reporting on the functionality of software. In addition, the guidance will highlight specific considerations for engagements involving smart contracts running on a blockchain. (In process; timing TBD – 2022). 	
Sustainability	<ul style="list-style-type: none"> Transformed the ESG Assurance Brochure from an awareness piece to an interactive call to action for member firms to provide to clients and potential customers Facilitated suitable criteria education for the SASB Research Team and Board Members on February 14, 2022 Cohosted a joint webcast with the Value Reporting Foundation and the CAQ on May 19, 2022 on the development of international sustainability reporting standards and reporting requirements for SEC registrants Observing the CFA Institute’s Examination Procedures for the CFA Institute ESG Disclosure Standards for Investment Products Working Group Updating Sustainability Attestation Guide to add chapter on climate-related disclosures 	<ul style="list-style-type: none"> Updating the Sustainability Attestation Guide for practice issues and SEC requirements Monitoring need for guidance (non-authoritative or authoritative) for performing Examination Procedures for the CFA Institute ESG Disclosure Standards for Investment Products Monitoring need for guidance (non-authoritative or authoritative) in connection with attestation engagements on sustainable debt
Artificial Intelligence/Algorithms		<ul style="list-style-type: none"> Monitoring need to controls framework for how to audit AI/SOC for AI Exploring academic research on explainable AI
Data Integrity		Monitor market use of criteria for evaluating the integrity of a set of data and decide if additional guidance is needed
Data Privacy	<ul style="list-style-type: none"> Developing nonauthoritative guidance for practitioners engaged to perform services around data privacy (In process) 	
Reporting on maturity models	<ul style="list-style-type: none"> See third-party assessments below 	Exploring potential for reporting on maturity models through development of a robust example
QCM Criteria	<ul style="list-style-type: none"> Working with the Quality Control Material (QCM) Task Force to exposure QCM attribute and description criteria to accompany QCM examination. 	
Third-Party Assessment Engagements		Monitor TPA Q&A and assess need for additional guidance/ standard