

## 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 auditor<sup>1</sup> regarding dividing responsibility for the audit of the company's financial statements<sup>2</sup> and, if applicable, internal control over financial reporting<sup>3</sup> with a referred-to auditor.<sup>4</sup>

Note: AS 2101 establishes requirements regarding serving as the lead auditor.<sup>5</sup>

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.<sup>6</sup>

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<sup>1</sup> The term “lead auditor,” as used in this standard, has the same meaning as defined in Appendix A of AS 2101, *Audit Planning*.

<sup>2</sup> 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.

<sup>3</sup> 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.

<sup>4</sup> The term “referred-to auditor,” as used in this standard, has the same meaning as defined in Appendix A of AS 2101.

<sup>5</sup> See paragraphs .06A–.06C of AS 2101.

<sup>6</sup> 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 units<sup>7</sup> audited by the referred-to auditor into the company's financial statements.<sup>8</sup> 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,<sup>9</sup>

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<sup>7</sup> The term "business units" includes subsidiaries, divisions, branches, components, or investments.

<sup>8</sup> 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.

<sup>9</sup> 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;<sup>10</sup> 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

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*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.

<sup>10</sup> 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.<sup>11</sup>

- 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;<sup>12</sup> 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.

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<sup>11</sup> 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.

<sup>12</sup> 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.<sup>13</sup>

.09 If the report of the referred-to auditor includes an opinion other than an unqualified opinion or includes explanatory language,<sup>14</sup> 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.

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<sup>13</sup> See, e.g., AS 2201.C10.

<sup>14</sup> 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 Chooses<sup>1</sup> 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.”*].

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<sup>1</sup> 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.<sup>2</sup>

#### 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

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<sup>2</sup> 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 Statements<sup>3</sup>***

**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

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<sup>3</sup> 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.<sup>4</sup>

#### 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]*

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<sup>4</sup> 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.