AU Section 543

Part of Audit Performed by Other Independent Auditors

Source: SAS No. 1, section 543; SAS No. 64.

See section 9543 for interpretations of this section.

Issue date, unless otherwise indicated: November, 1972.

.01 This section provides guidance on the professional judgments the independent auditor makes in deciding (*a*) whether he may serve as principal auditor and use the work and reports of other independent auditors who have audited the financial statements of one or more subsidiaries, divisions, branches, components, or investments included in the financial statements presented and (*b*) the form and content of the principal auditor's report in these circumstances.[1] Nothing in this section should be construed to require or imply that an auditor, in deciding whether he may properly serve as principal auditor without himself auditing particular subsidiaries, divisions, branches, components, or investments of his client, should make that decision on any basis other than his judgment regarding the professional considerations as discussed in paragraphs .02 and .10; nor should an auditor state or imply that a report that makes reference to another auditor is inferior in professional standing to a report without such a reference. [As modified, September 1981, by the Auditing Standards Board.]

Principal Auditor's Course of Action

.02 The auditor considering whether he may serve as principal auditor may have performed all but a relatively minor portion of the work, or significant parts of the audit may have been performed by other auditors. In the latter case, he must decide whether his own participation is sufficient to enable him to serve as the principal auditor and to report as such on the financial statements. In deciding this question, the auditor should consider, among other things, the materiality of the portion of the financial statements he has audited in comparison with the portion audited by other auditors, the extent of his knowledge of the overall financial statements, and the importance of the components he audited in relation to the enterprise as a whole. [As modified, September 1981, by the Auditing Standards Board.]

.03 If the auditor decides that it is appropriate for him to serve as the principal auditor, he must then decide whether to make reference in his report[2] to the audit performed by another auditor. If the principal auditor decides to assume responsibility for the work of the other auditor insofar as

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[1] Section 315 applies if an auditor uses the work of a predecessor auditor in expressing an opinion on financial statements.

[2] See paragraph .09 for example of appropriate reporting when reference is made to the audit of other auditors.

that work relates to the principal auditor's expression of an opinion on the financial statements taken as a whole, no reference should be made to the other auditor's work or report. On the other hand, if the principal auditor decides not to assume that responsibility, his report should make reference to the audit of the other auditor and should indicate clearly the division of responsibility between himself and the other auditor in expressing his opinion on the financial statements. Regardless of the principal auditor's decision, the other auditor remains responsible for the performance of his own work and for his own report.

Decision Not to Make Reference

.04 If the principal auditor is able to satisfy himself as to the independence and professional reputation of the other auditor (see paragraph .10) and takes steps he considers appropriate to satisfy himself as to the audit performed by the other auditor (see paragraph .12), he may be able to express an opinion on the financial statements taken as a whole without making reference in his report to the audit of the other auditor. If the principal auditor decides to take this position, he should not state in his report that part of the audit was made by another auditor because to do so may cause a reader to misinterpret the degree of responsibility being assumed.

.05 Ordinarily, the principal auditor would be able to adopt this position when:

a. Part of the audit is performed by another independent auditor which is an associated or correspondent firm and whose work is acceptable to the principal auditor based on his knowledge of the professional standards and competence of that firm; or

b. The other auditor was retained by the principal auditor and the work was performed under the principal auditor's guidance and control; or

c. The principal auditor, whether or not he selected the other auditor, nevertheless takes steps he considers necessary to satisfy himself as to the audit performed by the other auditor and accordingly is satisfied as to the reasonableness of the accounts for the purpose of inclusion in the financial statements on which he is expressing his opinion; or

d. The portion of the financial statements audited by the other auditor is not material to the financial statements covered by the principal auditor's opinion.

Decision to Make Reference

.06 On the other hand, the principal auditor may decide to make reference to the audit of the other auditor when he expresses his opinion on the financial statements. In some situations, it may be impracticable for the principal auditor to review the other auditor's work or to use other procedures which in the judgment of the principal auditor would be necessary for him to satisfy himself as to the audit performed by the other auditor. Also, if the financial statements of a component audited by another auditor are material in relation to the total, the principal auditor may decide, regardless of any other considerations, to make reference in his report to the audit of the other auditor.

.07 When the principal auditor decides that he will make reference to the audit of the other auditor, his report should indicate clearly, in both the introductory, scope and opinion paragraphs, the division of responsibility as between that portion of the financial statements covered by his own audit and that covered by the audit of the other auditor. The report should disclose the magnitude of the portion of the financial statements audited by the other auditor. This may be done 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 reveals the portion of the financial statements audited by the other auditor. The other auditor may be named but only with his express permission and provided his report is presented together with that of the principal auditor.[3]

.08 Reference in the report of the principal auditor to the fact that part of the audit was made by another auditor is not to be construed as a qualification of the opinion but rather as an indication of the divided responsibility between the auditors who conducted the audits of various components of the overall financial statements. [As modified, September 1981, by the Auditing Standards Board.]

.09 An example of appropriate reporting by the principal auditor indicating the division of responsibility when he makes reference to the audit of the other auditor follows:

Independent Auditor's Report

We have audited the consolidated balance sheet of X Company and subsidiaries as of December 31, 20...., and the related consolidated statements of income and retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of B Company, a wholly-owned subsidiary, which statements reflect total assets and revenues constituting 20 percent and 22 percent, respectively, of the related consolidated totals. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the report of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audit and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of X Company as of [*at*] December 31, 20...., and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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[3] As to filings with the Securities and Exchange Commission, see Rule 2-05 of Regulation S-X.

When two or more auditors in addition to the principal auditor participate in the audit, the percentages covered by the other auditors may be stated in the aggregate. [Revised, April 1998, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards Nos. 53 through 62. Revised, October 2000, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 93.]

Procedures Applicable to Both Methods of Reporting

.10 Whether or not the principal auditor decides to make reference to the audit of the other auditor, he should make inquiries concerning the professional reputation and independence of the other auditor. He also should adopt appropriate measures to assure the coordination of his activities with those of the other auditor in order to achieve a proper review of matters affecting the consolidating or combining of accounts in the financial statements. These inquiries and other measures may include procedures such as the following:

a. Make inquiries as to the professional reputation and standing of the other auditor to one or more of the following:

   (i) The American Institute of Certified Public Accountants,[4] the applicable state society of certified public accountants and/or the local chapter, or in the case of a foreign auditor, his corresponding professional organization.

   (ii) Other practitioners.

   (iii) Bankers and other credit grantors.

   (iv) Other appropriate sources.

b. Obtain a representation from the other auditor that he is independent under the requirements of the American Institute of Certified Public Accountants and, if appropriate, the requirements of the Securities and Exchange Commission (SEC).[4a]

c. Ascertain through communication with the other auditor:

   (i) That he is aware that the financial statements of the component which he is to audit are to be included in the financial statements on which the principal auditor will report and that the other auditor's report thereon will be relied upon (and, where applicable, referred to) by the principal auditor.

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[4] The AICPA Professional Ethics Division can respond to inquiries about whether individuals are members of the American Institute of Certified Public Accountants and whether complaints against members have been adjudicated by the Joint Trial Board. The division cannot respond to inquiries about public accounting firms or provide information about letters of required corrective action issued by the division or pending disciplinary proceedings or investigations. The AICPA Division for CPA Firms can respond to inquiries about whether specific public accounting firms are members of either the Private Companies Practice Section (PCPS) or the SEC Practice Section (SECPS), and can indicate whether a firm had a peer review in compliance with the Section's membership requirements and whether any sanctions against the firm have been publicly announced. In addition, the division will supply copies of peer-review reports that have been accepted by the applicable section of the division and information submitted by member firms on applications for membership and annual updates. The AICPA Practice Monitoring staff or the appropriate state CPA society can respond to inquiries as to whether specific public accounting firms are enrolled in the AICPA Peer Review Program and can indicate whether a firm had a peer review in compliance with the AICPA *Standards for Performing and Reporting on Peer Reviews* [PR section 100]. [As amended by the Auditing Standards Board, June 1990.]

[4a] [Footnote deleted, December 2001, to acknowledge the dissolution of the Independence Standard Board.]

(ii) That he or she is familiar with accounting principles generally accepted in the United States of America and with the generally accepted auditing standards promulgated by the American Institute of Certified Public Accountants and will conduct his or her audit and will report in accordance therewith.

(iii) That he has knowledge of the relevant financial reporting requirements for statements and schedules to be filed with regulatory agencies such as the Securities and Exchange Commission, if appropriate.

(iv) That a review will be made of matters affecting elimination of intercompany transactions and accounts and, if appropriate in the circumstances, the uniformity of accounting practices among the components included in the financial statements.

(Inquiries as to matters under *a*, and *c* (ii) and (iii) ordinarily would be unnecessary if the principal auditor already knows the professional reputation and standing of the other auditor and if the other auditor's primary place of practice is in the United States.) [As modified, September 1981, by the Auditing Standards Board. Revised, October 2000, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 93.]

.11 If the results of inquiries and procedures by the principal auditor with respect to matters described in paragraph .10 lead him to the conclusion that he can neither assume responsibility for the work of the other auditor insofar as that work relates to the principal auditor's expression of an opinion on the financial statements taken as a whole, nor report in the manner set forth in paragraph .09, he should appropriately qualify his opinion or disclaim an opinion on the financial statements taken as a whole. His reasons therefor should be stated, and the magnitude of the portion of the financial statements to which his qualification extends should be disclosed.

Additional Procedures Under Decision Not to Make Reference

.12 When the principal auditor decides not to make reference to the audit of the other auditor, in addition to satisfying himself as to the matters described in paragraph .10, he should also consider whether to perform one or more of the following procedures:

a. Visit the other auditor and discuss the audit procedures followed and results thereof.

b. Review the audit programs of the other auditor. In some cases, it may be appropriate to issue instructions to the other auditor as to the scope of his audit work.

c. Review the working papers of the other auditor, including the understanding of internal control and the assessment of control risk.

.13 In some circumstances the principal auditor may consider it appropriate to participate in discussions regarding the accounts with management personnel of the component whose financial statements are being audited by other auditors and/or to make supplemental tests of such accounts. The determination of the extent of additional procedures, if any, to be applied rests with the principal auditor alone in the exercise of his professional judgment and in no way constitutes a reflection on the adequacy of the other auditor's work. Because the principal auditor in this case assumes responsibility for his opinion on the financial statements on which he is reporting without making reference to the audit performed by the other auditor, his judgment must govern as to the extent of procedures to be undertaken.

Long-Term Investments

.14 With respect to investments accounted for under the equity method, the auditor who uses another auditor's report for the purpose of reporting on the investor's equity in underlying net assets and its share of earnings or losses and other transactions of the investee is in the position of a principal auditor using the work and reports of other auditors. Under these circumstances, the auditor may decide that it would be appropriate to refer to the work and report of the other auditor in his report on the financial statements of the investor. (See paragraphs .06-.11.) When the work and reports of other auditors constitute a major element of evidence with respect to investments accounted for under the cost method, the auditor may be in a position analogous to that of a principal auditor.

Other Auditor's Report Departs From Standard Report

.15 If the report of the other auditor is other than a standard report, the principal auditor should decide whether the reason for the departure from the standard report is of such nature and significance in relation to the financial statements on which the principal auditor is reporting that it would require recognition in his own report. If the reason for the departure is not material in relation to such financial statements and the other auditor's report is not presented, the principal auditor need not make reference in his report to such departure. If the other auditor's report is presented, the principal auditor may wish to make reference to such departure and its disposition.

Restated Financial Statements of Prior Years Following a Pooling of Interests

.16 Following a pooling-of-interests transaction, an auditor may be asked to report on restated financial statements for one or more prior years when other auditors have audited one or more of the entities included in such financial statements. In some of these situations the auditor may decide that he has not audited a sufficient portion of the financial statements for such prior year or years to enable him to serve as principal auditor (see paragraph .02). Also, in such cases, it often is not possible or it may not be appropriate or necessary for the auditor to satisfy himself with respect to the restated financial statements. In these circumstances it may be appropriate for him to express his opinion solely with respect to the combining of such statements; however, no opinion should be expressed unless the auditor has audited the statements of at least one of the entities included in the restatement for at least the latest period presented. The following is an illustration of appropriate reporting on such combination that can be presented in an additional paragraph of the auditor's report following the standard introductory, scope and opinion paragraphs covering the consolidated financial statements for the current year: *

> We previously audited and reported on the consolidated statements of income and cash flows of XYZ Company and subsidiaries for the year ended December 31, 19X1, prior to their restatement for the 19X2 pooling of interests. The contribution of XYZ Company and subsidiaries to revenues and net income represented . . . . . percent and . . . . . percent of the respective restated totals. Separate financial statements of the other companies included in the 19X1 restated consolidated statements of income and cash flows were audited and reported on separately by other auditors. We also audited the combination of the accompanying consolidated statements of income and cash flows for the year ended December 31, 19X1, after restatement for the 19X2 pooling of interests; in our opinion, such consolidated statements have been properly combined on the basis described in Note A of notes to consolidated financial statements.

[As modified, October 1980, by the Auditing Standards Board. As amended, effective for reports issued after December 31, 1990, by Statement on Auditing Standards No. 64.]

.17 In reporting on restated financial statements as described in the preceding paragraph, the auditor does not assume responsibility for the work of other auditors nor the responsibility for expressing an opinion on the restated financial statements taken as a whole. He should apply procedures which will enable him to express an opinion only as to proper combination of the financial statements. These procedures include testing the combination for clerical accuracy and the methods used to combine the restated financial statements for conformity with generally accepted accounting principles. For example, the auditor should make inquiries and apply procedures regarding such matters as the following:

a. Elimination of intercompany transactions and accounts.

b. Combining adjustments and reclassifications.

c. Adjustments to treat like items in a comparable manner, if appropriate.

d. The manner and extent of presentation of disclosure matters in the restated financial statements and notes thereto.

The auditor should also consider the application of procedures contained in paragraph .10. [As modified, October 1980, by the Auditing Standards Board.]

Predecessor Auditor

[.18] [Superseded by Statement on Auditing Standards No. 7, effective November 30, 1975, as superseded by Statement on Auditing Standards No. 84, effective with respect to acceptance of an engagement after March 31, 1998.] (See section 315.)

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* If restated consolidated balance sheets are also presented, the auditor may also express his opinion with respect to the combination of the consolidated balance sheets.