SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-85435; File No. PCAOB-2019-03]

Public Company Accounting Oversight Board; Notice of Filing of Proposed Rules on Amendments to Auditing Standards for Auditor's Use of the Work of Specialists


Pursuant to Section 107(b) of the Sarbanes-Oxley Act of 2002 (the "Act" or "Sarbanes-Oxley Act"), notice is hereby given that on March 20, 2019, the Public Company Accounting Oversight Board (the "Board" or "PCAOB") filed with the Securities and Exchange Commission (the "Commission" or "SEC") the proposed rules described in Items I and II below, which items have been prepared by the Board. The Commission is publishing this notice to solicit comments on the proposed rules from interested persons.

I. Board's Statement of the Terms of Substance of the Proposed Rules

On December 20, 2018, the Board adopted amendments to auditing standards for using the work of specialists (collectively, the "proposed rules"), including amendments to two existing auditing standards and the retitling and replacement of a third standard with an updated standard. The text of the proposed rules appears in Exhibit A to the SEC Filing Form 19b-4 and is available on the Board’s website at https://pcaobus.org/Rulemaking/Pages/docket-044-auditors-use-work-specialists.aspx and at the Commission’s Public Reference Room.

II. Board's Statement of the Purpose of, and Statutory Basis for, the Proposed Rules
In its filing with the Commission, the Board included statements concerning the purpose of, and basis for, the proposed rules and discussed any comments it received on the proposed rules. The text of these statements may be examined at the places specified in Item IV below. The Board has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements. In addition, the Board is requesting that, pursuant to Section 103(a)(3)(C) of the Sarbanes-Oxley Act, the Commission approve the proposed rules for application to audits of emerging growth companies ("EGCs"). The Board's request is set forth in section D.

A. Board's Statement of the Purpose of, and Statutory Basis for, the Proposed Rules

(a) Purpose

Summary

The Board has adopted amendments to its standards for using the work of specialists (i.e., a person or firm possessing special skill or knowledge in a particular field other than accounting or auditing), including amendments to two existing auditing standards and the retitling and replacement of a third standard with an updated standard. The amendments are intended to enhance investor protection by strengthening the requirements for evaluating the work of a company's specialist, whether employed or engaged by the company, and applying a supervisory approach to both auditor-employed and auditor-engaged specialists. The amendments are also designed to be risk-based and

scalable, so that the auditor's work effort to evaluate the specialist's work is commensurate with the risk of material misstatement associated with the financial statement assertion to which the specialist's work relates and the significance of the specialist's work to that assertion. These amendments should lead to more uniformly rigorous practices among audit firms of all sizes and enhance audit quality and the credibility of information provided in financial statements.

Companies across many industries use specialists to assist in developing accounting estimates in their financial statements. Companies may also use specialists to interpret laws, regulations, and contracts or to evaluate the characteristics of certain physical assets. Those companies may use a variety of specialists, including actuaries, appraisers, other valuation specialists, legal specialists, environmental engineers, and petroleum engineers. Auditors often use the work of these companies' specialists as audit evidence. Additionally, auditors frequently use the work of auditors' specialists to assist in their evaluation of significant accounts and disclosures, including accounting estimates in those accounts and disclosures.

As financial reporting frameworks continue to evolve and require greater use of estimates, including those based on fair value measurements, accounting estimates have become both more prevalent and significant. As a result, the use of the work of specialists also continues to increase in both frequency and significance. If a specialist's work is not properly overseen or evaluated by the auditor, there may be a heightened risk that the auditor's work will not be sufficient to detect a material misstatement in accounting estimates.
To address this challenge, the Board has adopted amendments to its auditing standards that primarily relate to auditors’ use of the work of specialists. First, AS 1105, *Audit Evidence*, is being amended to add a new Appendix A that addresses using the work of a company's specialist as audit evidence, based on the risk-based approach of the risk assessment standards.

New Appendix A of AS 1105:

- Supplements the requirements in AS 1105 for circumstances when the auditor uses the work of the company's specialist as audit evidence, including requirements related to:
  - Obtaining an understanding of the work and report(s), or equivalent communication, of the company's specialist(s) and related company processes and controls;
  - Obtaining an understanding of, and assessing, the knowledge, skill, and ability of a company's specialist and the entity that employs the specialist (if other than the company) and the relationship to the company of the specialist and the entity that employs the specialist (if other than the company); and
  - Performing procedures to evaluate the work of a company's specialist, including evaluating: (i) the data, significant assumptions, and methods (which may include models) used by the specialist, and (ii) the relevance and reliability of the specialist's work and its relationship to the relevant assertion.
• Aligns the requirements for using the work of a company's specialist with the risk assessment standards and the standard and related amendments adopted by the Board on auditing accounting estimates, including fair value measurements.

• Sets forth factors for determining the necessary evidence to support the auditor's conclusion regarding a relevant assertion when using the work of a company's specialist.

Second, the Board has also amended AS 1201, *Supervision of the Audit Engagement*, by adding a new Appendix C on supervising the work of auditor-employed specialists, and retitling and replacing AS 1210, *Using the Work of a Specialist* ("existing AS 1210"), with new AS 1210, *Using the Work of an Auditor-Engaged Specialist* ("AS 1210, as amended"), which sets forth requirements for using the work of auditor-engaged specialists.

New Appendix C of AS 1201:

• Supplements the requirements for applying the supervisory principles in AS 1201.05–.06 when using the work of an auditor-employed specialist to assist the auditor in obtaining or evaluating audit evidence, including requirements related to:
  
  • Informing the auditor-employed specialist of the work to be performed;
  
  • Coordinating the work of the auditor-employed specialists with the work of other engagement team members; and
• Reviewing and evaluating whether the work of the auditor-employed specialist provides sufficient appropriate evidence. Evaluating the work of the specialist includes evaluating whether the work is in accordance with the auditor's understanding with the specialist and whether the specialist's findings and conclusions are consistent with, among other things, the work performed by the specialist.

• Sets forth factors for determining the necessary extent of supervision of the work of the auditor-employed specialist.

AS 1210, as amended:

• Establishes requirements for using the work of an auditor-engaged specialist to assist the auditor in obtaining or evaluating audit evidence;

• Includes requirements for reaching an understanding with an auditor-engaged specialist on the work to be performed and reviewing and evaluating the specialist's work that parallel the final amendments to AS 1201 for auditor-employed specialists;

• Sets forth factors for determining the necessary extent of review of the work of the auditor-engaged specialist;

• Amends requirements related to assessing the knowledge, skill, ability, and objectivity of the auditor-engaged specialist; and

• Describes objectivity, for these purposes, as the auditor-engaged specialist's ability to exercise impartial judgment on all issues
encompassed by the specialist's work related to the audit, and specifies the auditor's obligations when the specialist or the entity that employs the specialist has a relationship with the company that affects the specialist's objectivity.

The final amendments strengthen the requirements for evaluating the work of a company's specialist and for supervising and evaluating the work of both auditor-employed and auditor-engaged specialists. The amendments also eliminate certain provisions of existing PCAOB standards, under which:

- The auditor has the same responsibilities under existing AS 1210 with respect to both a company's specialist and an auditor-engaged specialist, even though those specialists have fundamentally different roles (i.e., the company uses the work of its specialist in the preparation of the financial statements); and

- Auditor-employed specialists, but not auditor-engaged specialists, are subject to risk-based supervision, even though both serve similar roles in helping auditors obtain and evaluate audit evidence.

The Board adopted the final amendments after substantial outreach, including two rounds of public comment. In May 2015, the PCAOB issued a staff consultation paper to solicit views on various issues, including the potential need for standard setting. In June 2017, the Board requested comments on proposed amendments to the standards on using the work of specialists. The Board received comments on the staff consultation paper and the proposal. The Board's Standing Advisory Group ("SAG") also discussed this issue at several meetings. Commenters generally supported the Board's objective of improving
the quality of audits involving specialists, and suggested areas to further improve the amendments, modify proposed requirements that would not likely improve audit quality, and clarify the application of the amendments. In adopting these amendments, the Board has taken into account all of these comments and discussions, as well as observations from PCAOB oversight activities.

In its consideration of the final amendments, the Board is mindful of the significant advances in technology that have occurred in recent years, including increased use of data analysis tools and emerging technologies. An increased use of technology-based tools, together with future developments in the use of data and technology, could have a fundamental impact on the audit process. The Board is actively exploring these potential impacts through ongoing staff research and outreach. For example, the PCAOB staff is currently researching the effects on auditing of data analytics, artificial intelligence, distributed ledger technology, and other emerging technology, assisted by a task force of the SAG.2

In the context of this rulemaking, the Board considered how changes in technology could affect the use of specialists by companies, the use of the work of companies' specialists by auditors as audit evidence, and the use of auditor-employed and auditor-engaged specialists by auditors to obtain and evaluate audit evidence. The Board believes that the final amendments are sufficiently principles-based and flexible to accommodate continued advances in the use of data and technology by both companies

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and auditors. The Board will continue to monitor advances in this area and any effect they may have on the application of the final amendments.

The amendments will apply to all audits conducted under PCAOB standards. Subject to approval by the Commission, the amendments take effect for audits for fiscal years ending on or after December 15, 2020.

(b) Statutory Basis

The statutory basis for the proposed rules is Title I of the Act.

B. Board's Statement on Burden on Competition

Not applicable. The Board's consideration of the economic impacts of the proposed rules is discussed in section D below.

C. Board's Statement on Comments on the Proposed Rules Received from Members, Participants or Others

The Board released the proposed rules for public comment in Proposed Amendments to Auditing Standards for Auditor's Use of the Work of Specialists, PCAOB Release No. 2017-003 (June 1, 2017) ("Proposal"). The PCAOB also issued for public comment Staff Consultation Paper No. 2015-01, The Auditor's Use of the Work of Specialists (May 28, 2015) ("SCP"). Copies of Release No. 2017-003, the SCP, and the comment letters received in response to the PCAOB's requests for comment are available on the PCAOB's website at https://pcaobus.org/Rulemaking/Pages/docket-044-auditors-use-work-specialists.aspx. The PCAOB received 80 written comment letters. The Board's response to the comments received and the changes made to the rules in response to the comments received are discussed below.

Background

Companies across many industries use various types of specialists to assist in
developing accounting estimates in their financial statements.\textsuperscript{3} Companies may also use specialists to interpret laws, regulations, and contracts or to evaluate the characteristics of certain physical assets. Those companies may use a variety of specialists, including actuaries, appraisers, other valuation specialists, legal specialists, environmental engineers, and petroleum engineers. Auditors often use the work of these companies' specialists as audit evidence. In addition, auditors frequently use the work of auditors' specialists to assist in their evaluation of significant accounts and disclosures, including accounting estimates in those accounts and disclosures.

The use of fair value measurements and other accounting estimates continues to grow in financial reporting with, for example, increasing complexity in business transactions and changes in the financial reporting frameworks. As a result, the use of the work of specialists continues to increase in both frequency and significance.\textsuperscript{4} If a specialist's work is not properly overseen or evaluated, however, there is heightened risk that the auditor's work will not be sufficient to detect a material misstatement in accounting estimates.

The amendments to the standards for using the work of specialists are intended to improve audit quality by strengthening the requirements for evaluating the work of a company's specialist and applying a risk-based supervisory approach to both auditor-

\textsuperscript{3} As used in this notice, a specialist is a person (or firm) possessing special skill or knowledge in a particular field other than accounting or auditing.

\textsuperscript{4} See, e.g., Karin Barac, Elizabeth Gammie, Bryan Howieson, and Marianne van Staden, \textit{The Capability and Competency Requirements of Auditors in Today's Complex Global Business Environment}, at 83 (Mar. 2016) (report commissioned by the Institute of Chartered Accountants of Scotland and the Financial Reporting Council) (stating that "audit teams now include many more experts than in the past, and for some industries, particularly financial services, this was a welcome development.").
employed and auditor-engaged specialists. These enhancements should also lead to improvements in practices, commensurate with the associated risk, among audit firms of all sizes. The expected increase in audit quality should also enhance the credibility of information provided to investors.

**Rulemaking History**

The amendments to the auditing standards adopted by the Board (“final amendments” or “final requirements”) reflect public comments on both the SCP and the Proposal. In May 2015, the PCAOB issued the SCP to solicit comments on various issues related to the auditor's use of the work of a company's specialist and an auditor's specialist, including possible approaches for changes to PCAOB standards and the potential economic impacts of those alternatives.

In June 2017, the PCAOB issued the Proposal to solicit comments on amendments to PCAOB standards to strengthen the requirements for the auditor's use of the work of specialists. The Proposal was informed by comments on the SCP. The Board received 35 comment letters on the Proposal from commenters across a range of affiliations. The final amendments are informed by comments on the Proposal. Those comments are discussed throughout this notice.

In addition, the Board's approach has been informed by, among other things: (1) observations from PCAOB oversight activities and SEC enforcement actions; (2) the International Auditing and Assurance Standards Board's ("IAASB") and the American Institute of Certified Public Accountants' Auditing Standards Board's auditing standards
and IAASB's post-implementation review;⁵ (3) substantial outreach, including discussions with members of the SAG;⁶ and (4) the results of academic research.

**Overview of Existing Requirements**

The primary standard that applies when auditors use the work of auditor-engaged specialists or company specialists is existing AS 1210. The primary standard that applies when auditors use the work of auditor-employed specialists in an audit is AS 1201. Existing AS 1210 was adopted by the Board in 2003 shortly after the PCAOB's inception.⁷ AS 1201 was one of eight risk assessment standards adopted by the Board in 2010.⁸

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⁸ See Auditing Standards Related to the Auditor's Assessment of and Response to Risk and Related Amendments to PCAOB Standards, PCAOB Release No. 2010-004 (Aug. 5, 2010). Prior to 2010, auditors supervised employed specialists under AU sec. 311, *Planning and Supervision*. Additionally, paragraph .16 of AS 2101, *Audit Planning*, requires the auditor to determine whether specialized skill or knowledge is needed to perform appropriate risk assessments, plan or perform audit procedures, or evaluate audit results.
Existing AS 1210 provides that a specialist is "a person (or firm) possessing special skill or knowledge in a particular field other than accounting or auditing." 9

Existing AS 1210 also states that income taxes and information technology ("IT") are specialized areas of accounting and auditing, and therefore are outside the scope of the standard. 10

Existing AS 1210 applies when (1) a company engages or employs a specialist and the auditor uses that specialist's work as evidence in performing substantive tests to evaluate material financial statement assertions or (2) an auditor engages a specialist and uses that specialist's work as evidence in performing substantive tests to evaluate material financial statement assertions. 11

AS 1201 establishes requirements for the supervision of the audit engagement, including supervising the work of engagement team members. 12

The auditor supervises a specialist employed by the auditor's firm who participates in the audit under AS 1201. 13

As members of the engagement team under PCAOB auditing standards, auditor-employed specialists are to be assigned based on their knowledge, skill, and ability. 14

AS 1201 also applies in situations in which persons with specialized skill or knowledge in IT

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9 See existing AS 1210.01.

10 See footnote 1 of existing AS 1210.

11 See existing AS 1210.03.

12 See AS 1201.01.

13 See AS 1201.05–.06.

14 See paragraph .05a of AS 2301, The Auditor's Responses to the Risks of Material Misstatement, and paragraph .06 of AS 1015, Due Professional Care in the Performance of Work. In addition, the requirements in PCAOB auditing standards for determining compliance with independence and ethics requirements also include assessing the independence of auditor-employed specialists. See AS 2101.06b.
or income taxes participate in the audit, regardless of whether they are employed or engaged by the auditor's firm.\textsuperscript{15}

Using the work of a company's specialist and an auditor-engaged specialist under existing AS 1210. Existing AS 1210 requires that the auditor perform the following procedures when using the work of a company's specialist or an auditor-engaged specialist:

- Evaluate the professional qualifications of the specialist;\textsuperscript{16}
- Obtain an understanding of the nature of the specialist's work;\textsuperscript{17}
- Evaluate the relationship of the specialist to the company, including circumstances that might impair the specialist's objectivity;\textsuperscript{18} and
- In using the findings of the specialist:\textsuperscript{19}
  - Obtain an understanding of the methods and assumptions used by the specialist;
  - Make appropriate tests of data provided to the specialist; and
  - Evaluate whether the specialist's findings support the financial statement assertions.

\textsuperscript{15} See footnote 1 of existing AS 1210.
\textsuperscript{16} See existing AS 1210.08.
\textsuperscript{17} See existing AS 1210.09.
\textsuperscript{18} See existing AS 1210.10–.11.
\textsuperscript{19} See existing AS 1210.12.
Using the work of a company's specialist when auditing fair value measurements under AS 2502. In circumstances when a company's specialist develops assumptions used in a fair value measurement and the auditor tests the company's process, the auditor is required to evaluate the reasonableness of those assumptions as if the assumptions were developed by the company, as well as to comply with the requirements of existing AS 1210.

Supervising the work of auditor-employed specialists under AS 1201. This standard establishes requirements regarding the auditor's supervision of an audit engagement, including supervising the work of auditor-employed specialists and other members of the engagement team. AS 1201, as it relates to the supervision of auditor-employed specialists, provides that:

(1) The engagement partner and others who assist the engagement partner in supervising the audit should:

- Inform engagement team members of their responsibilities;
- Direct engagement team members to bring significant accounting and auditing issues arising during the audit to the attention of the engagement partner or other engagement team members performing supervisory activities; and

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21 See footnote 2 of AS 2502.
Review the work of engagement team members to evaluate whether:

- The work was performed and documented;
- The objectives of the procedures were achieved; and
- The results of the work support the conclusions reached.\(^{22}\)

(2) The necessary extent of supervision depends on, for example, the nature of the work performed, the associated risks of material misstatement, and the knowledge, skill, and ability of those being supervised.\(^{23}\)

**Existing Practice**

The PCAOB's understanding of audit practice at both larger audit firms\(^{24}\) and smaller audit firms\(^{25}\) under existing PCAOB standards has been informed by, among other things, the collective experience of PCAOB staff, observations from oversight

\(^{22}\) See AS 1201.05.

\(^{23}\) See AS 1201.06.

\(^{24}\) Unless otherwise indicated, the term "larger audit firms" refers to U.S. audit firms that are registered with the PCAOB and issue audit reports for more than 100 issuers (and are therefore annually inspected by the PCAOB). This term also refers to non-U.S. audit firms that are registered with the PCAOB and affiliated with one of the six largest global networks, based on information on network affiliations reported by non-U.S. audit firms on Form 2 in 2017 and identified on the "Global Network" overview page, available on the Board's website.

\(^{25}\) Unless otherwise indicated, the term "smaller audit firms" refers to PCAOB-registered audit firms that do not meet the definition of a "larger audit firm" as provided in footnote 24. These firms generally consist of firms that issued audit reports for 100 or fewer issuers and are not affiliated with any of the six largest global networks identified on the "Global Network" overview page, available on the Board's website.
activities of the Board, enforcement actions of the SEC, comments received on the Proposal, and discussions with the SAG, audit firms, and specialist entities.

These discussions have included outreach by the PCAOB staff to audit firms and specialist entities to obtain information on: (1) how auditors evaluate the competence and objectivity of auditor-engaged specialists and company specialists; (2) how auditors evaluate the work performed by an auditor-employed specialist, an auditor-engaged specialist, and a company's specialist; and (3) economic and demographic considerations relating to the market for services provided by specialists. The outreach has informed the PCAOB's understanding of existing practice at both larger and smaller audit firms. Most commenters who addressed the topic agreed that the Proposal accurately described existing audit practices regarding the use of the work of specialists. Commenters also generally supported the PCAOB's assessment that the use and importance of specialists has increased due to increasing complexity in business transactions and financial reporting requirements.

Overview of Existing Practice

When existing AS 1210 was originally issued in the early 1970s, the use of the work of specialists was largely confined to pension obligations, insurance reserves, and extractive industry reserves. Since then, the use of the work of specialists has increased in both frequency and significance.

Companies across many industries use the work of specialists to: (1) assist them in developing accounting estimates, including fair value measurements presented in the companies' financial statements; (2) interpret laws, regulations, and contracts; or (3) evaluate characteristics of physical assets, as shown in Figure 1 below. In those
circumstances, the reliability of a company's financial statements may depend in part on the quality of the work of a company's specialist.

*Figure 1: Examples of Activities that Involve the Work of Specialists*

<table>
<thead>
<tr>
<th>Valuation</th>
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<tbody>
<tr>
<td>Assets acquired and liabilities assumed in business combinations</td>
</tr>
<tr>
<td>Environmental remediation contingencies</td>
</tr>
<tr>
<td>Goodwill impairments</td>
</tr>
<tr>
<td>Insurance reserves</td>
</tr>
<tr>
<td>Intangible assets</td>
</tr>
<tr>
<td>Pension and other post-employment obligations</td>
</tr>
<tr>
<td>Impairment of real estate or other long-term assets</td>
</tr>
<tr>
<td>Financial instruments</td>
</tr>
</tbody>
</table>

*Legal interpretations*

| Legal title to property |
| Laws, regulations, or contracts |

*Evaluation of physical and other characteristics*

| Materials stored in stockpiles |
| Mineral reserves and condition |
| Oil and gas reserves |
| Property, plant, and equipment useful lives and salvage values |

Auditors also increasingly use the work of specialists in their audits. Auditors may:
• Use the work of a company's specialist—employed or engaged—as audit evidence; or

• Use the work of an auditor's specialist—employed or engaged—to assist the auditor in obtaining and evaluating audit evidence.

Figure 2 illustrates potential ways that auditors use specialists in an audit.

*Figure 2: Potential Ways Auditors Use Specialists in an Audit*

The company's specialist (A and B above) is employed or engaged by the company to perform work that the company uses in preparing its financial statements, which the auditor may use as audit evidence with respect to auditing significant accounts and disclosures. The auditor's specialist (C and D above) performs work to assist the auditor in obtaining and evaluating audit evidence with respect to a relevant assertion of a significant account or disclosure.

The PCAOB understands that audit practices under existing PCAOB standards vary among smaller and larger audit firms when auditors use the work of a specialist in
an audit. For example, smaller audit firms are more likely to use the work of a company's specialist than to employ or engage their own specialist. Larger audit firms generally require their engagement teams to evaluate the work of the company's specialist, including the specialist's methods and assumptions, and often employ specialists to assist their audit personnel in evaluating that work. The following paragraphs discuss in more detail the practices of smaller firms and larger firms in audits of issuers, brokers, and dealers under existing PCAOB standards.

**Smaller firm practices.** Smaller firm practices generally are based on the required procedures in existing PCAOB standards, primarily existing AS 1210. Smaller firms typically evaluate the competence, relationships to the company, and work of the company's specialist through inquiries of the company's specialist. For example, smaller firms may send a company's specialist a questionnaire to obtain information regarding the specialist's professional qualifications and the existence of relationships with the company that could impair the specialist's objectivity. Further, smaller firms typically do not evaluate the appropriateness of a specialist's methods (it is not required by existing AS 1210), and any evaluation by smaller firms of the assumptions of a company's specialist is generally confined to circumstances when the specialist develops assumptions used in a fair value measurement covered by AS 2502.

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26 As discussed in section D, an analysis of inspection data by PCAOB staff suggests that larger audit firms generally use the work of specialists more often than smaller audit firms do.

27 An analysis by PCAOB staff indicates that smaller firms predominantly use the work of an auditor's specialist in valuation areas, and seldom use the work of an auditor's specialist in other areas, whereas larger firms tend to use the work of an auditor's specialist in a wider range of audit areas, even though they also primarily use the work of specialists in valuation areas.
In circumstances when smaller firms engage an auditor's specialist, some firms perform the procedures specified in existing AS 1210. Other firms perform procedures similar to those in AS 1201 for supervising members of the engagement team. For example, some firms evaluate whether the auditor-engaged specialist's work supports the financial statement assertions, while other firms go further by also evaluating whether (1) the specialist's work was performed and documented, (2) the objectives of the specialist's procedures were achieved, and (3) the results of the specialist's work support the conclusions reached. One commenter noted that smaller firms may also use an auditor's specialist in evaluating the work of a company's specialist.

Larger firm practices. Some larger audit firms evaluate the methods and assumptions used by company specialists when they test the company's process for developing accounting estimates, even though this evaluation is currently required only for significant assumptions developed by the company's specialist in conjunction with fair value measurements and disclosures. Many larger firms employ their own specialists, who serve on engagement teams and assist with the evaluation of the work of company specialists.

Auditor-employed specialists at larger firms are generally involved early in the audit, usually during planning meetings with other members of the engagement team. Also, in planning the audit, auditors generally reach an understanding with auditor-employed specialists, documented in a memorandum, regarding the scope of work to be performed and the respective responsibilities of the auditor and the specialist. The items covered in that memorandum typically include: (1) the nature, scope, and objectives of

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28 See footnote 2 of AS 2502.
the specialist's work;\textsuperscript{29} (2) the role and responsibilities of the auditor and the specialist;\textsuperscript{30} and (3) the nature, timing, and extent of communication between the auditor and the specialist.\textsuperscript{31} The auditor communicates with the specialist as the work progresses to become aware of issues as they arise. When the specialist completes his or her work, the auditor reviews the specialist's work, which is typically documented in a separate report or memorandum.

In some instances, larger firms may use the work of a company's specialist without involving an auditor's specialist, particularly when the risk of material misstatement is low or the firm does not employ a specialist with expertise in the particular field. Alternatively, although infrequently, larger firms may engage a specialist with expertise in the particular field. When larger firms engage specialists, some firms perform the procedures specified in existing AS 1210 described above. Other firms perform procedures in such situations that are similar to the procedures for supervising the work of auditor-employed specialists under AS 1201.

Observations from Audit Inspections and Enforcement Cases

The Board's understanding of audit practice under existing PCAOB standards has been informed in part by observations from PCAOB oversight activities and SEC

\textsuperscript{29} Examples include whether the specialist is testing (or assisting in testing) the company's process for developing an accounting estimate or developing (or assisting in developing) an independent expectation of the estimate.

\textsuperscript{30} For example, the documentation might identify the respective responsibilities of the auditor and the specialist for evaluating data, significant assumptions, and methods used by the company or the company's specialist.

\textsuperscript{31} Examples include administrative matters, such as the timing, budget, and other staffing-related issues relevant to the specialist's work, or the protocols for discussing and resolving findings or issues identified by the specialist.
enforcement actions, including (1) audit deficiencies of both larger and smaller firms, and related remedial actions to address the deficiencies and (2) enforcement actions where the work of a specialist was used in the audit.

*Inspections observations.* Over the past several years, the observations from PCAOB inspections have included instances in which the auditor used the work of a company's specialist without performing the procedures required by existing PCAOB standards. Recent findings include instances in which auditors did not: (1) evaluate the reasonableness of assumptions used by a company's specialist in developing fair value measurements; (2) obtain an understanding of methods or assumptions used by the company's specialist; (3) test the accuracy and completeness of company-provided data used by the company's specialist; or (4) evaluate the professional qualifications of the company's specialist.

Over the past several years, the observations from PCAOB inspections also have indicated that auditors, at times, did not fulfill their responsibilities under existing standards when using the work of an auditor's specialist. These findings were more common than those related to using the work of a company's specialist over the same period. The observations included instances in which auditors did not: (1) reach an understanding with the specialist regarding his or her responsibilities; (2) adequately evaluate the work performed by the specialist; or (3) consider contradictory evidence identified by the specialist or resolve discrepancies or other concerns that the specialist identified. More recently, PCAOB inspection staff have observed a decline in the number

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32 See existing AS 1210 and AS 2502.
of instances by some firms in which auditors did not perform sufficient procedures related to the work of an auditor's specialist.

There are indications that some firms have undertaken remedial actions in response to the findings related to the auditor's use of the work of an auditor's specialist. In most cases, such actions included enhancements to firm methodologies to improve coordination between the auditor and the auditor's specialist through earlier and more frequent communications. These enhancements may have contributed, at least in part, to the decline in findings described above. Not all firms, however, have changed their methodologies, resulting in inconsistent practices in this area. In addition, unlike the findings related to the auditor's use of the work of an auditor's specialist, PCAOB inspections staff have not observed a similar change in the frequency of findings related to the auditor's use of the work of a company's specialist.

Enforcement actions. Both the SEC\textsuperscript{33} and the PCAOB\textsuperscript{34} have brought enforcement actions involving situations where auditors allegedly failed to comply with auditing standards when using the work of specialists. For example, such proceedings

\textsuperscript{33} See, e.g., KPMG LLP and John Riordan, CPA, SEC Accounting and Auditing Enforcement Release ("AAER") No. 3888 (Aug. 15, 2017); Miller Energy Resources, Inc., Paul W. Boyd, CPA, David M. Hall, and Carlton W. Vogt, III, CPA, AAER No. 3673 (Aug. 6, 2015); Troy F. Nilson, CPA, SEC AAER No. 3264 (Apr. 8, 2011); and Accounting Consultants, Inc., and Carol L. McAtee, CPA, SEC AAER No. 2447 (June 27, 2006).

have involved allegations that auditors failed to (1) perform audit procedures to address the risks of material misstatements in a company's financial statements that were prepared in part based on the work of a company's specialist\(^{35}\) or (2) comply with certain requirements of existing AS 1210 when using the work of a company's specialist (for example, requirements to evaluate the professional qualifications of the specialist, obtain an understanding of the methods and assumptions used by the specialist, evaluate the relationship of the specialist to the company, and apply additional procedures to address a material difference between the specialist's findings and the assertions in the financial statements).\(^{36}\) Several of those proceedings were brought in recent years, suggesting that problems persist in this area.

**Reasons to Improve Auditing Standards**

The improvements to PCAOB standards are intended to direct auditors to devote more attention to the work of a company's specialist and enhance the coordination between an auditor and the auditor's specialist—employed or engaged. The final amendments also align with the Board's risk assessment standards and acknowledge more clearly the different roles of a company's specialist, an auditor-employed specialist, and an auditor-engaged specialist. The Board believes that these improvements will enhance

\(^{35}\) *See, e.g., Gordon Brad Beckstead, CPA, PCAOB Release No. 105-2015-007.)*

both audit quality and the credibility of the information provided in a company's financial statements.

Areas of Improvement

The Board has identified two important areas where improvements are warranted to existing standards, discussed below: (1) strengthening the requirements for evaluating the work of a company's specialist and (2) applying a risk-based supervisory approach to auditor-employed and auditor-engaged specialists.

Strengthening the requirements for evaluating the work of a company's specialist

Existing AS 1210 is the primary standard that applies when auditors use the work of an auditor-engaged specialist or a company's specialist. By its terms, existing AS 1210 applies when (1) a company engages or employs a specialist and the auditor uses that specialist's work as evidence in performing substantive tests to evaluate material financial statement assertions or (2) an auditor engages a specialist and uses that specialist's work as evidence in performing substantive tests to evaluate material financial statement assertions.

In practice, however, a company's specialist and an auditor-engaged specialist have fundamentally different roles: the company uses the work of a specialist in the preparation of its financial statements, whereas an auditor's specialist performs work to assist the auditor in obtaining and evaluating audit evidence. By imposing the same requirements for using the work of a company's specialist and an auditor-engaged specialist, existing AS 1210 does not clearly reflect the different roles of such specialists.
In addition, existing AS 1210 does not expressly require an auditor to evaluate the appropriateness of a company specialist's methods and assumptions. Instead, it requires the auditor to obtain an understanding of the methods and assumptions used by the specialist, a less rigorous procedure. Existing AS 1210 also includes certain provisions that circumscribe the auditor's responsibilities related to the work of a specialist, including statements that: (1) the appropriateness and reasonableness of methods and assumptions used, and their application, are the responsibility of the specialist; (2) the auditor ordinarily would use the work of the specialist unless the auditor's procedures lead him or her to believe the findings are unreasonable in the circumstances; and (3) if the auditor determines that the specialist's findings support the related assertions in the financial statements, he or she reasonably may conclude that sufficient appropriate evidential matter has been obtained.

When an auditor uses the work of a company's specialist, the requirements in existing AS 1210 allow the auditor to plan and perform audit procedures that may not be commensurate with the risk of material misstatement inherent in the work of the specialist, thereby allowing the auditor to use the work and conclusions of a company's specialist without performing procedures to evaluate that specialist's work. Some audit firms, primarily larger firms, go beyond the requirements in existing AS 1210 and generally require their engagement teams to evaluate the work of a company's specialist,

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37 The evaluation of the reasonableness of assumptions developed by a company's specialist is required only in circumstances when the specialist develops assumptions used in a fair value measurement in accordance with AS 2502. AS 2502 is being superseded in a separate PCAOB release. See Estimates Release, supra note 20.

38 See existing AS 1210.12–.13.
including the specialist's methods and assumptions, and often employ specialists to assist their audit personnel in evaluating that work. Existing audit practices in this regard, however, vary among firms.

The foregoing factors indicate that improvements to PCAOB standards for using the work of a company's specialists are needed and that increasing auditors' attention to the work of a company's specialists with respect to significant accounts and disclosures will enhance investor protection. In the Board's view, investor protection will be enhanced by requiring auditors to do more than merely obtain an understanding of the methods and significant assumptions used by the specialist.

**Applying a risk-based supervisory approach to both auditor-employed and auditor-engaged specialists**

The primary standard that applies when auditors use the work of an auditor-employed specialist in an audit is AS 1201. That standard establishes requirements regarding the auditor's supervision of the audit engagement, including supervision of a specialist employed by the auditor's firm who participates in the audit. While AS 1201 is risk-based and scalable, it does not specifically address how to apply its supervisory procedures to promote effective coordination between an auditor and a specialist and evaluation by the auditor of the work of an auditor-employed specialist.

The primary standard that applies when auditors use the work of an auditor-engaged specialist in an audit is existing AS 1210. The requirements in this standard differ from and are less rigorous than the requirements that apply when using auditor-employed specialists, even though auditor-employed and auditor-engaged specialists serve similar roles in helping auditors to obtain and evaluate audit evidence. For example, existing AS 1210 provides that the auditor should "obtain an understanding" of the nature
of the work performed by an auditor-engaged specialist, including the objectives and scope of the specialist's work, whereas AS 1201 requires the auditor to review the work of an auditor-employed specialist to "evaluate" whether the work was performed and documented, the objectives of the procedures were achieved, and the results of the work support the conclusions reached.

The PCAOB's observations regarding existing audit practices in this area also reveal differences in the application of the auditing standards regarding the use of the work of auditor-employed and auditor-engaged specialists. For example, in circumstances when audit firms engage specialists, some firms perform the procedures specified in existing AS 1210, while other firms perform procedures that are similar to the procedures for supervising the work of auditor-employed specialists under AS 1201.

These factors indicate that investor protection can be enhanced by improving PCAOB standards for applying a risk-based supervisory approach to auditor-employed specialists, and extending those requirements to auditor-engaged specialists. This should promote a more uniform approach to the supervision of an auditor's specialists, whether employed or engaged, reflecting their similar roles. Specifically, investor protection can be enhanced by supplementing the existing supervision requirements under PCAOB standards with more specific direction on applying those principles when supervising the work of auditor-employed and auditor-engaged specialists. This includes, among other things, additional direction on reaching an understanding with auditor-employed and auditor-engaged specialists on the work to be performed and on reviewing and evaluating their work.

Comments on the Reasons for Standard Setting
Many commenters on the Proposal broadly expressed support for revisions to the Board's standards for using the work of specialists or stated that the Proposal would lead to improvements in audit quality. For example, some commenters agreed with statements in the Proposal that the increasing use of specialists, due in part to the increasing use of fair value measurements in financial reporting frameworks and increasing complexity of business transactions, warranted strengthening existing requirements. A number of commenters also indicated that the requirements for using specialists should be risk-based and more closely aligned with the Board's risk assessment standards than existing standards. One of these commenters stated that the Board should be proactive in addressing issues relating to auditors' use of the work of specialists through standard setting as an alternative to devoting additional resources to inspections and enforcement based on existing standards.

In addition, a number of commenters generally agreed with developing separate standards for using the work of a company's specialist, an auditor-employed specialist, and an auditor-engaged specialist. One commenter noted that separating these requirements could lead to better application in practice, especially among smaller CPA firms, while another commenter indicated that providing separate guidance for using the work of company specialists, auditor-employed specialists, and auditor-engaged specialists would be an improvement over existing standards. One commenter stated that inspections of audits involving the use of specialists had shown a need for improvement, and that the rationalization and enhancement of existing requirements would improve the efficiency and quality of audits.
A few commenters on the Proposal questioned the reasons for revisions to PCAOB auditing standards relating to the use of the work of specialists. One commenter stated that the Proposal presented no clear evidence that audit deficiencies found by the PCAOB relating to the use of specialists resulted from deficiencies in the auditing standards. Another commenter stated that inspection findings did not necessarily warrant revisions to auditing standards and that it continued to question whether a fundamental change in audit standards was necessary. A third commenter stated that it did not believe that the case had been made for having separate standards for the use of auditor-employed and auditor-engaged specialists. Finally, a fourth commenter suggested that the Board should develop additional information on potential costs before proposing or adopting revisions to existing auditing standards, including through field testing of potential changes.

The SAG has discussed specialist-related issues at a number of meetings. Many SAG members expressed support for: (1) greater auditor responsibility for evaluating the work performed by a company's specialists; (2) similar responsibilities when auditors use the work of auditor-employed specialists and auditor-engaged specialists; and (3) better

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39 Some commenters provided comments or expressed concerns about specific aspects of the proposed revisions to the Board's existing standards for using the work of specialists. The Board's consideration of these comments is discussed further below.

40 See below for a more detailed discussion of the final amendments and clarifications of certain aspects of the proposed amendments, as set forth in the Proposal.

communication between auditors and their specialists, whether employed or engaged. Some SAG members, however, questioned the need for changes to the existing standards, asserting that auditors may not always have the necessary level of expertise to evaluate the work of certain specialists and, as a result, may need to rely on the work of specialists.

In adopting the final amendments, the Board has taken into account the comments received on the Proposal, as well as its other outreach activities. The information available to the Board—including the current regulatory baseline, observations from the Board's oversight activities, and substantial outreach—suggests that investors would benefit from strengthened and clarified standards for auditors in this area. The Board notes that aspects of the required procedures in the final amendments are similar to current auditing practices by some larger and smaller audit firms. While the Board does not expect that the final amendments will eliminate inspection deficiencies observed in practice, the final amendments are intended to clarify the auditor's responsibilities and align the requirements for using the work of specialists more closely with the Board's risk assessment standards. The final amendments also reflect a number of changes that were made after the Board's consideration of comments received on the Proposal about the potential impact of the proposed requirements on auditors, issuers, and specialists.42

Overview of Final Rules

The final amendments: (1) add an appendix to AS 1105 with supplemental requirements for using the work of a company's specialist as audit evidence; (2) add an

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42 See below for a more detailed discussion of changes reflected in the final amendments and section D for a more detailed discussion of economic considerations related to the adoption of the final amendments.
appendix to AS 1201 with supplemental requirements for supervising an auditor-employed specialist; and (3) replace existing AS 1210 with an updated standard for using the work of an auditor-engaged specialist. The key aspects of these amendments, which are intended to enhance the requirements in existing standards for using the work of a company's specialist, an auditor-employed specialist, and an auditor-engaged specialist, are discussed in this section. The ways in which the final amendments address the need for change from an economic perspective are discussed in section D.

The final amendments have been informed by the Board's outreach activities. They are aligned with the Board's risk assessment standards, so that the necessary audit effort is commensurate with, among other things, the significance of the specialist's work to the auditor's conclusion regarding the relevant assertion and the associated risk. Many commenters on the Proposal supported aligning any new standards on using the work of specialists with any new standards related to auditing accounting estimates, including fair value measurements. The final amendments are aligned with the Estimates Release.

Figure 3 summarizes the auditor's responsibilities and primary PCAOB standards for using the work of specialists applicable before and after the effective date of the final amendments.
**Figure 3: Auditor Responsibilities and Primary Standards for Using the Work of Specialists**

<table>
<thead>
<tr>
<th>Nature of Specialist's Involvement</th>
<th>Before Effective Date of Final Amendments</th>
<th>After Effective Date of Final Amendments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company's Specialist</td>
<td>Specialist employed or engaged by the company</td>
<td>Auditor performs the procedures required by existing AS 1210</td>
</tr>
<tr>
<td>Auditor's Specialist</td>
<td>Auditor-engaged specialist</td>
<td>Auditor supervises the specialist under AS 1201</td>
</tr>
<tr>
<td></td>
<td>Auditor-employed specialist</td>
<td>Auditor supervises the specialist under AS 1201</td>
</tr>
</tbody>
</table>

In brief, the final amendments make the following changes to PCAOB auditing standards:

- **Amend AS 1105.**
  - Add a new Appendix A\(^{43}\) that supplements the requirements in AS 1105 for circumstances when the auditor uses the work of the company's specialist as audit evidence, related to:
    - Obtaining an understanding of the work and report(s), or equivalent communication, of the company's

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\(^{43}\) As proposed, these requirements would have been set forth as Appendix B to AS 1105.
specialist(s) and related company processes and controls;  

- Obtaining an understanding of and assessing the knowledge, skill, and ability of a company's specialist and the entity that employs the specialist (if other than the company) and the relationship to the company of the specialist and the entity that employs the specialist (if other than the company); and

- Performing procedures to evaluate the work of a company's specialist, including evaluating: (i) the data, significant assumptions, and methods (which may include models) used by the specialist, and (ii) the relevance and reliability of the specialist's work and its relationship to the relevant assertion;

- Align the requirements for using the work of a company's specialist with the risk assessment standards and the standard and

44 See AS 1105.A2, as adopted. Additionally, as amended, AS 2110, Identifying and Assessing Risks of Material Misstatement, sets forth requirements for understanding company processes and controls related to the use of specialists.

45 This evaluation is not explicitly required under the Board's existing standards, other than under AS 2502 with respect to the significant assumptions of a company's specialist regarding fair value measurements and disclosures.
related amendments adopted by the Board on auditing accounting estimates, including fair value measurements;46 and

- Set forth factors for determining the necessary evidence to support the auditor's conclusion regarding a relevant assertion when using the work of a company's specialist.

- **Amend AS 1201.**

- Add a new Appendix C that supplements the requirements for applying the supervisory principles in AS 1201.05–.06 when using the work of an auditor-employed specialist to assist the auditor in obtaining or evaluating audit evidence, including requirements related to:
  - Informing the auditor-employed specialist of the work to be performed;
  - Coordinating the work of the auditor-employed specialists with the work of other engagement team members; and
  - Reviewing and evaluating whether the work of the auditor-employed specialist provides sufficient appropriate evidence. Evaluating the work of the specialist includes evaluating whether the work is in

46 Certain provisions of the final amendments include references to a new auditing standard AS 2501, *Auditing Accounting Estimates, Including Fair Value Measurements* ("AS 2501, as adopted"), which has been adopted by the Board in a separate release. See Estimates Release, *supra* note 20.
accordance with the auditor's understanding with the specialist and whether the specialist's findings and conclusions are consistent with, among other things, the work performed by the specialist.

- Set forth factors for determining the necessary extent of supervision of the work of the auditor-employed specialist.

- *Replace existing AS 1210.*

- Replace with AS 1210, as amended, *Using the Work of an Auditor-Engaged Specialist*, which establishes requirements for using the work of an auditor-engaged specialist to assist the auditor in obtaining or evaluating audit evidence;

- Include requirements for reaching an understanding with an auditor-engaged specialist on the work to be performed and reviewing and evaluating the specialist's work that parallel the final amendments to AS 1201 for auditor-employed specialists;

- Set forth factors for determining the necessary extent of review of the work of the auditor-engaged specialist;

- Amend requirements related to assessing the knowledge, skill, ability, and objectivity\(^{47}\) of the auditor-engaged specialist; and

\(^{47}\) Under the final amendments, the term "objectivity" is reserved for the auditor-engaged specialist and not used to describe the relationship to the company of a company's specialist or an auditor-employed specialist. See below for further discussion of objectivity.

37
Describe objectivity, for purposes of the standard, as the auditor-engaged specialist's ability to exercise impartial judgment on all issues encompassed by the specialist's work related to the audit; and specify the auditor's obligations when the specialist or the entity that employs the specialist has a relationship with the company that affects the specialist's objectivity.

The Board has also adopted a single standard to replace its existing standards on auditing accounting estimates and fair value measurements and set forth a uniform, risk-based approach designed to strengthen and enhance the requirements for auditing accounting estimates. Certain provisions of the final amendments in this notice include references to AS 2501, as adopted.

Most of those who commented on the proposed requirements regarding the use of the company's specialist expressed support for strengthening the requirements for evaluating the work of a company's specialist and aligning them with the Board's risk assessment standards. For example, one commenter stated that it agreed with statements in the Proposal that the proposed requirements may result in some auditors gaining a better understanding of a company's critical accounting estimates related to relevant financial statements and disclosures. Another commenter stated that the application of a risk-based approach to the testing and evaluation of the work of a company's specialist

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48 As discussed in the Estimates Release, supra note 20, the Board is retitling and replacing existing AS 2501, Auditing Accounting Estimates, and superseding AS 2502 and AS 2503, Auditing Derivative Instruments, Hedging Activities, and Investments in Securities. AS 2501, as adopted, also includes a special topics appendix that addresses certain matters relevant to auditing the fair value of financial instruments, including the use of pricing information from third parties as audit evidence.
would reduce the risk of an auditor failing to sufficiently address the risks of material misstatement.

A few commenters disagreed with the approach, or aspects of the approach, for evaluating the work of a company's specialist as described in the Proposal. One commenter asserted that additional clarification for using the work of a company's specialist was needed to address practicability issues and avoid unnecessary costs. Another commenter suggested that the amendments should place greater weight on the professional requirements and certifications for certain company specialists.

The Board recognizes that the auditor does not have the same expertise as a person trained or qualified to engage in the practice of another profession. At the same time, establishing a uniform, risk-based approach for using the work of a company's specialist more clearly acknowledges the different roles of a company's specialist and an auditor's specialist and builds upon improvements observed in the practices of certain firms. The final amendments also clarify aspects of the proposed amendments, including the procedures for evaluating the work of a company's specialist, so that the required procedures are both practical and risk-based, and reasonably designed to lead to improvements in audit quality.\textsuperscript{49}

Commenters on the proposed requirements for using an auditor's specialist generally agreed with a risk-based supervisory approach for both auditor-employed and auditor-engaged specialists. For example, one commenter agreed that this approach would promote an improved, more uniform approach to the supervision of an auditor's specialist.

\textsuperscript{49} See below for a more detailed discussion of the final amendments and clarifications regarding using the work of a company's specialist.
specialists. Consistent with the view of these commenters, the final amendments apply a risk-based supervisory approach to both auditor-employed and auditor-engaged specialists, which should enhance investor protection.

The subsections that follow discuss in more detail the final amendments. The subsections also include a comparison of the final requirements with the analogous requirements of the following standards issued by the IAASB and the Auditing Standards Board ("ASB") of the American Institute of Certified Public Accountants:

**IAASB Standards**
- International Standard on Auditing 500, *Audit Evidence* ("ISA 500"); and
- International Standard on Auditing 620, *Using the Work of an Auditor’s Expert* ("ISA 620").

**ASB Standards**
- AU-C Section 500, *Audit Evidence* ("AU-C Section 500"); and
- AU-C Section 620, *Using the Work of an Auditor’s Specialist* ("AU-C Section 620").

The comparison included in these subsections may not represent the views of the IAASB or ASB regarding the interpretation of their standards. The information presented in the subsections does not cover the application and explanatory material in the IAASB standards or ASB standards.\(^{50}\)

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\(^{50}\) Paragraph A59 of ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, indicates that the application and other explanatory material section of the ISAs "does not in itself impose a requirement" but "is relevant to the proper application of the requirements of an ISA." Paragraph A64 of AU-C Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Generally Accepted
Scope of Final Amendments

The final amendments apply when an auditor uses the work of a "specialist." Thus, the scope of the requirements hinges largely on the meaning of the term "specialist." As described in the Proposal, the Board sought to carry forward the meaning of the term "specialist" from existing AS 1210, that is, a specialist is a person (or firm) possessing special skill or knowledge in a particular field other than accounting or auditing. The Board also sought to carry forward the concept from existing AS 1210 that income taxes and IT are specialized areas of accounting and auditing and thus are outside the scope of the final amendments. As discussed below, the final amendments retain, as proposed, the meaning of the term "specialist," including the concept regarding income taxes and IT.

Some commenters on the Proposal agreed with retaining the existing meaning of the term "specialist." Other commenters suggested that the Board extend the scope of the Proposal to include persons with specialized skill or knowledge in certain areas of income taxes and IT (e.g., unusual or complex tax matters, artificial intelligence, and blockchain). One of these commenters also asserted that income tax and IT professionals often support both audit and consulting practices and, as a practical matter, are treated as specialists by auditors. One commenter requested guidance for applying the proposed requirements when a legal specialist is involved, while another commenter suggested that

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*Auditing Standards*, states that, although application and other explanatory material "does not in itself impose a requirement, it is relevant to the proper application of the requirements of an AU-C section."

51 *See* footnote 1 of existing AS 1210.
the Board explain in the final amendments that an individual who specializes in complex taxation law would be a legal specialist.

One commenter suggested eliminating the distinction between expertise "inside" or "outside" the field of accounting and auditing with respect to an auditor's specialist because, in its view, determining when fields of expertise are outside of accounting and auditing is becoming more difficult. Another commenter stated that, in practice, it can be less than straightforward to differentiate between expertise in auditing and accounting and other areas. Other commenters, however, asserted that the Board should retain the concept in existing AS 1210 that an auditor is not expected to have the expertise of a person trained or qualified to engage in the practice of another profession or occupation.

As used today, the term "specialist" is generally understood by auditors, and observations from PCAOB oversight activities do not indicate that there is significant confusion over the meaning of the terms "specialist" and "specialized area of accounting and auditing," as they have been used in the standards. After considering the comments received on the Proposal, however, the final amendments retain the meaning of the term "specialist" as proposed, with certain clarifications discussed below.

Specifically, the Board included a note to clarify when the final amendments apply to the work of an attorney used by the company. As under existing AS 1210, specialists under the final amendments include attorneys engaged by a company as specialists, such as attorneys engaged by the company to interpret contractual terms or provide a legal opinion. The final amendments apply when an auditor uses the work of a company's attorney as audit evidence in other matters relating to legal expertise, such as when a

\[52\] See second note to AS 1105.A1, as adopted.
legal interpretation of a contractual provision or a legal opinion regarding isolation of transferred financial assets is necessary to determine appropriate accounting or disclosure under the applicable financial reporting framework. The final amendments also clarify that the scope of these amendments does not apply to information provided by a company's attorney concerning litigation, claims, or assessments that is used by the auditor pursuant to AS 2505, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments*.

Consistent with existing AS 1210, income taxes and IT are outside the scope of the final amendments because they are specialized areas of accounting and auditing. For example, while specialized areas of income tax law involve legal specialists, accounting for income taxes remains an area of accounting and auditing. The Board added a footnote to Appendix A of AS 1105 that references AS 2505.08, as amended. A note to AS 2505.08, as amended, clarifies the auditor's responsibility regarding the use of the written advice or opinion of a company's tax advisor or a company's tax legal counsel as audit evidence. Also, to the extent that IT is used in information systems, auditors will still need to maintain sufficient technical knowledge to identify and assess risks and design procedures to respond to those risks and evaluate the audit evidence obtained. Accordingly, the Board does not believe that the need exists at this time to change the approach reflected in existing AS 1210 and designate particular areas of either income taxes or IT as outside the field of "accounting and auditing."

**Comparison with Standards of Other Standard Setters**

53 See footnote 1 to AS 1105.A1, as adopted.

54 See note to AS 2505.08, as amended.
ISA 620 uses the terms "auditor's expert" and "management's expert" in a manner analogous to the term "specialist" in the final amendments. ISA 620, however, does not address whether IT is a specialized field outside of accounting and auditing. The term "management's expert" is also defined in ISA 500.

AU-C Section 620 and AU-C Section 500 use the word "specialist" instead of "expert."

Amendments Related to Using the Work of a Company's Specialist

The final amendments set forth requirements for using the work of a company's specialist as audit evidence. The amendments, which supplement the existing requirements of AS 1105, include:

- Obtaining an understanding of the work and report(s), or equivalent communication, of the company's specialist(s) and related company processes and controls;
- Obtaining an understanding of and assessing the knowledge, skill, and ability of the specialist and the entity that employs the specialist (if other than the company), and the relationship to the company of the specialist and the entity that employs the specialist (if other than the company); and
- Performing procedures to evaluate the work of a company's specialist, including evaluating: (1) the data, significant assumptions, and methods (which may include models) used by the specialist; and (2) the relevance
and reliability of the specialist's work and its relationship to the relevant assertion.\textsuperscript{55}

Commenters on the Proposal generally supported a risk-based approach for using the work of a company's specialist, as set forth in the proposed amendments. Many commenters also stated that there was a need to establish a separate standard for using the work of a company's specialist. However, a number of commenters questioned various aspects of the amendments, including the need for revisions to existing AS 1210 relating to the use of the work of a company's specialist. Additionally, some commenters requested clarifications or suggested changes to the proposed requirements. These and other comments are discussed below. A number of these comments resulted in revisions and clarifications to the final amendments.

\textit{Obtaining an Understanding of the Work of the Company's Specialist}

\textit{See AS 1105.A2, as adopted, and AS 2110.28A, as adopted}

The proposed amendments to AS 1105 provided that obtaining an understanding of the company's information system relevant to financial reporting would encompass obtaining an understanding of the work and report(s) of the company's specialist(s) and related company processes and controls.\textsuperscript{56}

\textsuperscript{55} Key principles from Auditing Interpretation AI 11, \textit{Using the Work of a Specialist: Auditing Interpretations of AS 1210}, and Auditing Interpretation AI 28, \textit{Evidential Matter Relating to Income Tax Accruals: Auditing Interpretations}, related to the auditor's use of the work of a company's attorney and the use of written tax advice or opinions as audit evidence have been incorporated in AS 1105.A1, as adopted, and a note added to AS 2505.08, as amended.

\textsuperscript{56} See proposed AS 1105.B2.
Some commenters supported the proposed requirement because, in their view, an understanding of the company's processes for using the work of company specialists is integral to the auditor's understanding of the information system relevant to financial reporting. Two commenters asserted that such controls are important for the auditor to consider when evaluating the work of a company's specialist and determining the necessary audit procedures. One commenter expressed concern that the proposed requirement was too broad and suggested that the auditor's understanding should instead be part of the evaluation of the specialist's objectivity. In addition, two commenters questioned whether the Board intended to require the auditor to evaluate the design of controls over the use of company specialists, even if the auditor was not performing an audit of internal control over financial reporting or planning to rely on controls for the related assertions. These commenters and others suggested that placing the proposed requirement for obtaining an understanding of the specialist's work in AS 2110 would better link the requirement to the auditor's risk assessment procedures, thereby reducing the likelihood that auditors would consider only the factors in proposed AS 1105.B2 and fail to consider other relevant factors set forth in AS 2110.

The Board considered these comments and is adopting the requirement substantially as proposed, but relocating the requirement to AS 2110 as suggested by certain commenters.\footnote{Specifically, the requirements are located in AS 2110.28A, as adopted.} The procedure builds upon a requirement in existing AS 1210 that the auditor obtain an understanding of the nature of the work performed or to be performed by a specialist,\footnote{See existing AS 1210.09.} but is more closely aligned with the required risk assessment
procedures in AS 2110. The required procedure is important because it informs the 
auditor's evaluation of the work of the company's specialist, and not merely the 
assessment of the specialist's objectivity.

Placing the requirement for obtaining an understanding of the specialist's work 
and report(s), or equivalent communication, in AS 2110, and framing the required 
procedure as a risk assessment procedure, provides better direction regarding the 
necessary audit effort for the procedure. The necessary audit effort for performing this 
procedure is governed primarily by the general requirements in AS 2110 for obtaining a 
sufficient understanding of the company's internal control over financial reporting. 59 This 
includes consideration of whether the auditor plans to use the specialist's work as audit 
evidence.

While the requirement, as adopted, likely will not represent a major change in 
practice, particularly for those firms whose practices already go beyond existing PCAOB 
standards, it should prompt auditors to appropriately consider the interaction of the 
specialist's work and the company's related processes and controls. For example, under 
the final amendments, the auditor should obtain an understanding of controls for using 

59 See AS 2110.18, which provides that the auditor should obtain a sufficient 
understanding of each component of internal control over financial reporting to: 
(1) identify the types of potential misstatements, (2) assess the factors that affect the risks 
of material misstatement, and (3) design further audit procedures. See also AS 2110.19, 
which further provides that the nature, timing, and extent of procedures that are necessary 
to obtain an understanding of internal control depend on the size and complexity of the 
company; the auditor's existing knowledge of the company's internal control over 
financial reporting; the nature of the company's controls, including the company's use of 
IT; the nature and extent of changes in systems and operations; and the nature of the 
company's documentation of its internal control over financial reporting. In addition, AS 
2110.20 provides that obtaining an understanding of internal control includes evaluating 
the design of controls that are relevant to the audit and determining whether the controls 
have been implemented.
the work of specialists that are relevant to the audit, including evaluating the design of those controls and determining whether those controls have been implemented.\textsuperscript{60}

Comparison with Standards of Other Standard Setters

The requirements in ISA 500 and AU-C 500 have some commonality with the requirements in the final amendments. Paragraph 8(b) of ISA 500 states that, if information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary and having regard to the significance of that expert's work for the auditor's purposes, obtain an understanding of the work of that expert.

AU-C Section 500 contains requirements that are similar to those in ISA 500.

Assessing the Knowledge, Skill, and Ability of the Company's Specialist and the Specialist's Relationship to the Company

\textit{See AS 1105.A3–A5, as adopted}

The final amendments set forth requirements similar to existing AS 1210 for evaluating the knowledge, skill, and ability of the specialist and the relationship of the specialist to the company.\textsuperscript{61}

Knowledge, Skill, and Ability

The Proposal set forth a requirement similar to that in existing AS 1210 for evaluating the professional qualifications of the specialist and generally provided the

\textsuperscript{60} AS 2110.34 provides additional direction for determining controls relevant to the audit.

\textsuperscript{61} Existing AS 1210.08 and AS 1210.10–.11 require the auditor to evaluate the professional qualifications of a specialist and the relationship of a specialist to the company.
same factors for the auditor's assessment of the specialist's knowledge, skill, and ability.62

The Proposal differed from existing AS 1210, however, in certain respects. First, the Proposal extended the required understanding to expressly include the entity that employs the specialist, if the specialist is not employed by the company. Second, the Proposal expressly referred to the specialist's "level" of knowledge, skill, and ability. As with the auditor's assessment of competence under AS 2605, Consideration of the Internal Audit Function, this approach recognized that specialists may possess varying degrees of knowledge, skill, and ability. Third, the Proposal provided that the necessary evidence to assess the level of knowledge, skill, and ability of the company's specialist would depend on (1) the significance of the specialist's work to the auditor's conclusion regarding the relevant assertion and (2) the risk of material misstatement of the relevant assertion. Under this approach, the persuasiveness of the evidence the auditor would need to obtain increases as the significance of the specialist's work to the auditor's conclusion or the risk of material misstatement of the relevant assertion increases.63

The Board is adopting the requirement for evaluating the professional qualifications of the specialist as proposed. Most commenters on this aspect of the

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62 Existing AS 1210.08 provides that the auditor should consider certain information in evaluating the professional qualifications of the specialist to determine that the specialist possesses the necessary skill or knowledge in the particular field. The information to be considered in that evaluation is: (1) the professional certification, license, or other recognition of the competence of the specialist in his or her field, as appropriate; (2) the reputation and standing of the specialist in the views of peers and others familiar with the specialist's capability or performance; and (3) the specialist's experience in the type of work under consideration.

63 Illustrative examples on the application of these factors when testing and evaluating the work of a company's specialist appear in the discussion on determining the necessary audit effort under AS 1105.A7, as provided below.
Proposal acknowledged the need for the auditor to obtain an understanding of and assess the knowledge, skill, and ability of a company's specialist. One commenter asserted that the proposed requirement was not well-suited to assessing the qualifications of the entity that employs the specialist. The Board considered this comment and notes that the final requirement retains the concept in existing AS 1210 that a specialist may be an individual or an entity. Accordingly, auditors should be familiar with assessing the qualifications of entities that are specialists or employ specialists. Furthermore, a strong reputation and standing of the specialist's employer in the specialized field can be a signal that the employer maintains qualified staff. On the other hand, an employer with a poor reputation or little expertise in the specialized field can indicate that more scrutiny of the qualifications of the individual specialist is warranted.

Some commenters asked for more direction on how to obtain an understanding of the professional qualifications of the company's specialist and the entity that employs the specialist (for example, by including in the rule text the discussion from the proposing release of potential sources of information about a specialist's qualifications). One of these commenters asserted that there are practical limits on obtaining evidence related to a company-engaged specialist's competence.

The Board considered these comments, but notes that the final requirement is similar to a requirement in existing AS 1210. Outreach to audit firms suggests that firms have policies and procedures for evaluating the qualifications of specialists, whether individuals or entities. Auditors should therefore be familiar with the process of assessing the knowledge, skill, and ability of entities that employ specialists.
As with existing AS 1210, the final amendments do not set forth specific steps to perform in assessing the specialist's knowledge, skill, and ability. It is not practicable to provide detailed direction in this area because of the variety of types of specialists that may be encountered. Examples of potential sources of information that, if available, could be relevant to the auditor's evaluation include:

- Information contained within the audit firm related to the professional qualifications and reputation of the specialist or the entity that employs the specialist (if other than the company) in the relevant field and experience with previous work of the specialist;
- Professional or industry associations and organizations, which may provide information regarding: (1) qualification requirements, technical performance standards, and continuing professional education requirements that govern their members; (2) the specialist's education and experience, certification, and license to practice; and (3) recognition of, or disciplinary actions taken against, the specialist;
- Discussions with the specialist, through the company, about matters such as the specialist's understanding of the financial reporting framework, the specialist's experience in performing similar work, and the methods and assumptions used in the specialist's work the auditor plans to evaluate;
- Information obtained as part of audit planning, when obtaining an understanding of the company's processes and identifying controls for testing;
• Information included in the specialist's report about the specialist's professional qualifications (e.g., a biography or resume);
• Responses to questionnaires provided to the specialist regarding the specialist's professional credentials; and
• Published books or papers written by the specialist.

Requirements applicable to a specialist pursuant to legislation or regulation also could help inform the auditor's assessment of the specialist's knowledge, skill, and ability. Some of the examples listed above may provide more persuasive evidence than others. For example, relevant information from a source not affiliated with the company or specialist, the auditor's experience with previous work of the specialist, or multiple sources generally would provide more persuasive evidence than evidence from the specialist's uncorroborated representations about his or her professional credentials. Additionally, the reliability (and thus persuasiveness) of information about the specialist's credentials and experience increases when the company has effective controls over that information, e.g., in conjunction with controls over the selection of qualified specialists.

Some commenters asked for clarification as to how the company's controls and processes for using the work of a company's specialist should be considered when performing the assessment of knowledge, skill, and ability. As discussed earlier, the interaction of the specialist's work and the company's processes should be considered by the auditor in assessing and responding to risk in the related accounts and disclosures.

64 As previously discussed, the risk of material misstatement of the relevant assertion and the significance of the specialist's work to the auditor's conclusion regarding the relevant assertion affect the persuasiveness of the evidence needed with respect to the knowledge, skill, and ability of the company's specialist.
especially when the specialist's work is significant to the auditor's conclusion regarding the relevant assertion and the accounts or disclosures have higher risk. Therefore, the company's controls and processes are considered in identifying and appropriately assessing the risks of material misstatement of the relevant assertion, which is one of the two factors that the auditor considers under AS 1105.A5, as adopted, in determining the necessary evidence for assessing the specialist's level of knowledge, skill, and ability.

Relationship to the Company

The Proposal provided that the auditor would assess the relationship to the company of the specialist and the entity that employs the specialist (if other than the company)—specifically, whether circumstances exist that give the company the ability to significantly affect the specialist's judgments about the work performed, conclusions, or findings (e.g., through employment, financial, ownership, or other business relationships, contractual rights, family relationships, or otherwise). The proposed requirement was similar to existing AS 1210.10, but expanded the list of matters that the auditor should consider to include financial and business relationships with the company.

The Board is adopting this requirement substantially as proposed, with the addition of a note that sets forth examples of potential sources of information that could be relevant to the auditor's assessment.

Some commenters supported the proposed requirement for the auditor to assess the specialist's relationship to the company and stated that it was appropriate. Two commenters, however, asserted that there could be practical challenges to assessing the relationship to the company of the entity that employs the specialist (e.g., if the entity that employs the specialist lacks systems to track such relationships or the auditor does not
have access to those systems). The Board considered these comments, but notes that existing AS 1210 already requires an evaluation of the relationship of the specialist, whether an individual or an entity, to the client. Outreach to audit firms suggests that firms have policies and procedures for evaluating the objectivity of specialists, whether individuals or entities. Therefore, auditors should be familiar with assessing the qualifications of entities that are specialists or employ specialists.

Other commenters asked for additional direction regarding the necessary effort to obtain information regarding the specialist's relationship to the company. One commenter also emphasized the importance of considering ethical and performance requirements promulgated by a specialist's profession or by legislation or regulation governing the specialist. The final amendments do not prescribe specific steps to perform in assessing the specialist's relationship to the company, because additional specificity would make the requirements unnecessarily prescriptive. The Board has added a note to the final requirement, however, that includes non-exclusive examples of potential sources of information that could be relevant to the auditor's assessment of the relationship to the company of both the specialist and the specialist's employer (if other than the company). These examples include disclosures by the specialist about relationships with the company in the specialist's report, or equivalent communication, pursuant to requirements promulgated by the specialist's profession or by legislation governing the specialist. As with the auditor's assessment of a specialist's knowledge, skill, and

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65 See note to AS 1105.A4, as adopted. These examples were based on examples set forth in the Proposal, but have been refined to better reflect their application in practice.

66 While the Proposal had suggested that information regarding such
ability, certain sources of information may provide more persuasive evidence than others. In situations where more persuasive evidence is required under these requirements, it may be appropriate to perform procedures to obtain evidence from multiple sources.

Some commenters also expressed a preference for retaining the term "objectivity" with respect to a company's specialist and further acknowledging that objectivity may exist along a spectrum. Similar to the Proposal, the final amendments reserve the term "objectivity" for specialists engaged by the auditor to assist in obtaining and evaluating audit evidence. The work of a company's specialist is different in nature from the work of an auditor's specialist, since a company's specialist performs work that the company frequently uses as source material for one or more financial statement accounts or disclosures, including accounting estimates. With respect to the existence of objectivity along a spectrum, the final amendments recognize that a company's ability to significantly affect a specialist's judgment may vary and, as discussed below, provide a spectrum for evaluating the company's ability to significantly affect the specialist's judgments.

As was proposed, the final amendments provide that, if the auditor identifies relationships between the company and the specialist (or the specialist's employer, if other than the company), the auditor has a responsibility to assess whether the company has the ability to significantly affect the specialist's judgments about the work performed, requirements could be relevant to the auditor's evaluation of the specialist's relationships to the company, disclosures about relationships pursuant to such requirements are more relevant to the auditor's assessment than merely information about the legal or professional requirements.
conclusions, or findings. Examples of the types of circumstances that might give the company the ability to affect the specialist's judgments include, but are not limited to:

- The reporting relationship of a company-employed specialist within the company;
- Compensation of a company's specialist based, in part, on the outcome of the work performed;
- Relationships a company-engaged specialist has with entities acting as an agent of the company;
- Personal relationships, including family relationships, between the company's specialist and others within company management;
- Financial interests, including stock holdings, company specialists have in the company; and
- Ownership, business relationships, or other financial interests the employer of a company-engaged specialist has with respect to the company.

The auditor's assessment that the company has the ability to influence the specialist, however, does not preclude the auditor from using the work of a company's specialist, whether employed or engaged, as audit evidence. Rather, consistent with existing AS 1210, it is a factor in determining the necessary audit effort to evaluate that

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See AS 1105.A4, as adopted.
specialist's work.\textsuperscript{68} In general, the necessary audit effort increases as the company's ability to affect the specialist's judgments increases.

**Determining the Necessary Evidence**

The Proposal differed from existing AS 1210 in that it set forth scalable requirements for determining the necessary evidence for evaluating both the knowledge, skill, and ability of the specialist and the relationship of the specialist to the company.

The Board is adopting these requirements as proposed. Under the final amendments, the necessary evidence to assess the level of knowledge, skill, and ability of the company's specialist and the specialist's relationship to the company depends on (1) the significance of the specialist's work to the auditor's conclusion regarding the relevant assertion and (2) the risk of material misstatement of the relevant assertion. As the significance of the specialist's work and risk of material misstatement increases, the persuasiveness of the evidence the auditor should obtain for those assessments also increases.\textsuperscript{69}

No commenters opposed the proposed framework for determining the necessary evidence. A number of commenters, however, asked for clarification on the application of the requirement when performing the relevant evaluations. The Board's analysis of these comments is discussed above in connection with the required evaluations of the specialist's knowledge, skill, and ability, and the relationship of the specialist to the company.

\textsuperscript{68} See AS 1105.A7--A10, as adopted. Examples that illustrate how relationships between the company and the company's specialist can affect the necessary audit effort in evaluating the work of a company's specialist under the final amendments appear in the discussion on determining the necessary evidence, as provided below.

\textsuperscript{69} See AS 1105.A5, as adopted.
Comparison with Standards of Other Standard Setters

Paragraph 8(a) of ISA 500 provides that, if information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary and having regard to the significance of that expert's work for the auditor's purposes, evaluate the competence, capabilities, and objectivity of that expert.

AU-C Section 500 contains requirements that are similar to those in ISA 500.

Evaluating the Work of the Company's Specialist

See AS 1105.A6–A10, as adopted

In general, a specialist's work involves using data, assumptions, and methods. The auditor's responsibilities under existing AS 1210 with respect to the data, assumptions, and methods used by the specialist are limited to (a) obtaining an understanding of the methods and assumptions used by the specialist and (b) making appropriate tests of data provided to the specialist. In addition, the auditor should evaluate whether the specialist's findings support the related assertions in the financial statements. Ordinarily, the auditor would use the work of the specialist unless the auditor's procedures lead the auditor to believe the findings are unreasonable in the circumstances. If the auditor believes the specialist's findings are unreasonable, he or she is required to apply additional procedures, which may include potentially obtaining

70 For fair value measurements, however, another standard requires the auditor to evaluate the reasonableness of significant assumptions of the specialist. See footnote 2 of AS 2502. This standard is being superseded in the Estimates Release, supra note 20.

71 See existing AS 1210.12.

72 Id.
the opinion of another specialist. Notably, before the final amendments, PCAOB standards have not expressly addressed how to determine the necessary audit effort to be applied in performing those procedures.

The Proposal sought to enhance the requirements for testing and evaluating the work of the company's specialist by:

- Extending the auditor's responsibilities for evaluating the specialist's assumptions to include all significant assumptions used by the specialist (not just those used in fair value measurements);
- Expanding the auditor's responsibilities with respect to data to include evaluating external data used by the specialist (not just data provided by the company to the specialist);
- Adding a requirement for the auditor to evaluate the appropriateness of the methods used by the specialist, including whether the data was appropriately applied;
- Setting forth a requirement for the auditor to comply with the Board's proposed estimates standard when the auditor tests management's process for developing an estimate and a company's specialist was used; and

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\(^{73}\) Id.

• Providing direction for determining the necessary audit effort for testing and evaluating the specialist's work, based on the risk of material misstatement and other factors set forth in the standard.

Commenters expressed mixed views on the premise underlying the Proposal that the auditor should test and evaluate the work of a company's specialist. While a number of commenters supported that premise, other commenters opposed expanding the auditor's responsibilities with respect to the specialist's methods and assumptions beyond existing AS 1210. Some of these commenters expressed concerns that the auditor may not be qualified to evaluate the work of a specialist and recommended retaining the more limited audit approach reflected in existing AS 1210, including the statement that "the auditor is not expected to have the expertise of a person trained for or qualified to engage in practice of another profession or occupation."

A number of commenters also addressed specific aspects of the proposed requirements for testing and evaluating the work of company specialists. Some commenters questioned the proposal's general use of the term "test" in describing the auditor's responsibilities, as well as the proposed requirement to also comply with the proposed estimates standard in circumstances where the auditor tests management's process for developing an estimate and a company's specialist was also used. Those commenters asserted that the expected audit effort was unclear. Two commenters stated that the proposed requirements in this area could be interpreted as requiring reperformance of the specialist's work, which one of these commenters asserted would be beyond the expertise of most auditors and thus require auditors to use an auditor's specialist.
In addition, some commenters requested clarification on the expectations for evaluating a specialist's models, especially in situations where auditors are unable to gain access to proprietary models used by company-engaged specialists. Some commenters also expressed concern about the proposed requirement to evaluate whether data was appropriately used by the specialist. Some of these commenters asserted that this requirement appeared to require auditors to reperform the specialist's work and suggested clarifying or eliminating that requirement. Additionally, some commenters suggested allowing auditors to rely on the issuer's controls over the use of specialists in determining the necessary procedures for evaluating the specialist's work.

A number of commenters acknowledged that the proposed requirements were intended to be scalable. However, some commenters questioned whether they would be scalable in practice. Other commenters asked for guidance on tailoring audit procedures based on risk and the other factors set forth in the Proposal, especially procedures under the proposed requirement to also comply with the proposed estimates standard. Also, some commenters asserted that the requirements did not adequately distinguish the audit effort based on whether the specialist was engaged or employed by the company.

After considering the comments on the Proposal, the Board is retaining the fundamental approach in the Proposal – under which the auditor evaluates the data, significant assumptions, and methods used by the specialist. This approach is intended to increase audit attention on the work of a company's specialist, particularly when that work is significant in areas of higher risk, to increase the likelihood that the auditor would detect material financial statement misstatements related to that work.
Taking into account comments on specific aspects of the proposed requirements, however, the final amendments reflect a number of clarifying revisions to eliminate or revise certain proposed requirements that may have been perceived by commenters as unnecessarily complex or prescriptive. The revisions address concerns expressed by certain commenters, while preserving the intended benefits of the final amendments, and include:

- Removing the word "test" from the requirements to evaluate the work of the company's specialist, except in relation to company-produced data; and

- Reframing the requirements for evaluating the data, significant assumptions, and methods used by the specialist to describe the key considerations in making those evaluations.

In addition, the final amendments clarify the applicability of the requirements in circumstances when the company's specialist is involved in developing an accounting estimate, such as developing assumptions and methods used in an accounting estimate. In such circumstances, the requirements in Appendix A of AS 1105 apply to evaluating the data, significant assumptions\(^{75}\), and methods developed (or generated) by the specialist, or sourced by the specialist from outside the company, as well as to testing company-produced data. In contrast, for significant assumptions provided by management to the

\(^{75}\) A footnote to AS 1105.A8, as adopted, refers the auditor to AS 2501.15, as adopted, for the procedures to perform when identifying significant assumptions. For purposes of identifying significant assumptions, the company's assumptions include assumptions developed by the company's specialist.
specialist, the auditor is required to look to the requirements in AS 2501, as adopted. The final amendments are discussed in more detail below.

Evaluating the Specialist's Work: Data, Significant Assumptions, and Methods

See AS 1105.A6 and .A8, as adopted

The revisions reflected in the final amendments clarify the auditor's responsibilities for evaluating the work of a company's specialist, and are intended to avoid potential confusion that the auditor is required to reperform the work of the company's specialist. Among other things, the revised requirements reserve the use of the term "test" for procedures applied to company-produced information used by the specialist, consistent with its usage in AS 2501, as adopted.\footnote{See Estimates Release, \textit{supra} note 20.}

Notably, instead of requiring the auditor to comply with AS 2501, as adopted, the auditor would be required to apply a set of analogous procedures for evaluating data, significant assumptions, and methods that are tailored to situations in which specialists are used.\footnote{A note to AS 1105.A6, as adopted, emphasizes that paragraphs .16–.17 of AS 2101 describe the auditor's responsibilities for determining whether specialized knowledge or skill is needed. This includes determining whether an auditor's specialist is needed to evaluate the work of a company's specialist.} For example, under the final amendments, the auditor's responsibilities with respect to data, significant assumptions, and methods used by the specialist generally are:

\begin{itemize}
\item \textit{Company-produced data}: Test the accuracy and completeness of company-produced data used by the specialist (see AS 1105.A8a, as adopted);\footnote{See also AS 1105.10 for procedures when the auditor uses information produced by the company as audit evidence.}
\end{itemize}
• **Data from sources external to the company:** Evaluate the relevance and reliability of the data from sources external to the company that are used by the specialist (see AS 1105.A8a, as adopted);

• **Significant assumptions:** Evaluate whether the significant assumptions used by the specialist are reasonable:

  (1) *Assumptions developed by the specialist:* taking into account the consistency of those assumptions with relevant information (see AS 1105.A8b(1), as adopted);

  (2) *Assumptions provided by company management and used by the specialist:* looking to the requirements set forth in AS 2501.16–.18, as adopted (see AS 1105.A8b(2), as adopted);

  (3) *Assumptions based on the company's intent and ability to carry out a particular course of action:* looking to the requirements set forth in AS 2501.17, as adopted (see AS 1105.A8b(3), as adopted); and

• **Methods:** Evaluate whether the methods used by the specialist are appropriate under the circumstances, taking into account the requirements of the applicable financial reporting framework (see AS 1105.A8c, as adopted).

Under the final amendments, the focus of the auditor's evaluation of the work of the company's specialist does not require reperforming the specialist's work or evaluating whether the work complies with all technical aspects in the specialist's field. Instead, the auditor's responsibility is to evaluate whether the specialist's work provides sufficient appropriate evidence to support a conclusion regarding whether the corresponding
accounts or disclosures in the financial statements are in conformity with the applicable financial reporting framework.

With respect to the specialist's methods, the auditor's responsibilities under PCAOB standards have historically been to understand the method used. The final amendments extend that obligation to encompass evaluating whether the method is appropriate under the circumstances, taking into account the requirements of the applicable financial reporting framework.\(^79\) In many cases, evaluating a method's conformity with the applicable financial reporting requirements is the same as evaluating its appropriateness under the circumstances (e.g., if the applicable accounting standard requires a particular method for determining the estimate). However, if the applicable financial reporting framework allows more than one method, or if the appropriate method under the framework depends on the circumstances, evaluating conformity with the framework involves consideration of other relevant factors, such as, the nature of the estimate and the auditor's understanding of the company and its environment.

A note to the final amendments also clarifies that evaluating the specialist's methods includes assessing whether the data and significant assumptions are appropriately applied under the applicable financial reporting framework.\(^80\) Evaluating the application of the data encompasses, for example, whether the data is selected and adjusted in conformity with the requirements of the applicable financial reporting framework. Similarly, evaluating the application of significant assumptions encompasses

\(^79\) See AS 1105.A8c, as adopted.

\(^80\) See note to AS 1105.A8c, as adopted.
evaluating whether the assumptions were selected in conformity with the requirements of the applicable financial reporting framework.

The final amendments do not require the auditor to obtain access to proprietary models used by the specialist. Rather, the auditor's responsibility is to obtain information to assess whether the model is in conformity with the applicable financial reporting framework. Depending on the model and the factors set forth in AS 1105.A7, as adopted, this might involve, for example, obtaining an understanding of the model, reviewing descriptions of the model in the specialist's report or equivalent communication, testing controls over the company's evaluation of the specialist's work, or assessing the inputs to and output from the model (if necessary, using an alternative model for comparison).

With respect to the specialist's significant assumptions, auditors have historically had an obligation under PCAOB standards to understand the assumptions and, for fair value measurements, to evaluate the reasonableness of the assumptions. The final amendments extend the auditor's obligation to include evaluating the reasonableness of significant assumptions used by the specialist. This involves comparing the assumptions to relevant information. The note accompanying AS 1105.A8b(1), as adopted, provides examples of information that, if relevant, should be taken into account: (1) assumptions generally accepted within the specialist's field; (2) supporting information provided by the specialist; (3) industry, regulatory, and other external factors, including economic conditions; (4) the company's objectives, strategies, and related business risks; (5) existing market information; (6) historical or recent experience, along with changes in

81 See existing AS 1210.09.

82 See footnote 2 of AS 2502.
conditions and events affecting the company; and (7) significant assumptions used in other estimates tested in the company's financial statements. These examples—including examples (1) and (2), which were suggested by commenters—point to information that generally would be available to the auditor (e.g., through other procedures performed on the audit or the auditor's knowledge or the company and its industry).

Furthermore, the final amendments provide that, if a significant assumption is provided by company management and used by the specialist, the auditor should look to the requirements in AS 2501.16–18, as adopted. The final amendments also provide that, if a significant assumption is based on the company's intent and ability to carry out a particular course of action, the auditor should look to the requirements set forth in AS 2501.17, as adopted. This applies regardless of whether the significant assumption was developed by the company or the company's specialist.

**Determining the Necessary Audit Effort for Evaluating the Specialist's Work**

See AS 1105.A7, as adopted

Similar to the Proposal, the final amendments set forth four factors that affect the necessary evidence from the auditor's evaluation of the specialist's work to support a conclusion regarding a relevant assertion. Specifically, under the final amendments, the necessary evidence depends on the: (1) significance of the specialist's work to the auditor's conclusion regarding the relevant assertion; (2) risk of material misstatement of the relevant assertion; (3) level of knowledge, skill, and ability of the specialist; and

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83 As noted previously, this factor includes consideration of professional requirements the specialist is required to follow.
(4) the ability of the company to significantly affect the specialist's judgments about the work performed, conclusions, or findings.

Some commenters asked for additional clarification or direction on how to apply the four factors to determine the necessary audit effort for evaluating the specialist's work. One commenter requested that the Board elaborate upon certain terms (e.g., terms "extensively" and "less extensive procedures") that were used in two of the three examples that were included in the Proposal to illustrate how certain factors could affect the necessary audit effort in evaluating the work of a company's specialist. Another commenter requested that the Board provide additional examples of less complex scenarios.

In addition, some commenters asserted that the Proposal did not adequately account for differences between company-employed and company-engaged specialists. These commenters stated that the nature and extent of an auditor's procedures with respect to the work of a company-engaged specialist with the necessary knowledge, skill, and objectivity should not necessarily be the same as those for the work of a company-employed specialist. One commenter suggested expressly including in the list of factors performance standards that the specialist is required to follow.

The requirements regarding determining the necessary audit effort for evaluating the specialist's work were adopted substantially as proposed. The changes to the procedural requirements for evaluating the data, significant assumptions, and methods used by the specialist should help address concerns about the necessary level of effort under the appendix. Also, the three examples included in the Proposal have been revised to align with the final amendments and expanded to address factors that lead to more or
less audit attention and illustrate how the additional attention may be directed under the circumstances.

With respect to the distinction between company-employed and company-engaged specialists, the Board believes that the final amendments provide an appropriate framework for distinguishing the work effort when using the work of such specialists. In particular, one of the four factors related to determining the necessary audit effort is the ability of the company to significantly affect the specialist's judgments about the work performed, conclusions, or findings. This factor is discussed in more detail above.

Specifically, under the four factors set forth in the final amendments, the auditor should obtain more persuasive evidence as the significance of the specialist's work, the risk of material misstatement, or the ability of the company to affect the specialist's judgments increases, or as the level of knowledge, skill, and ability possessed by the specialist decreases. In general, the required audit effort when evaluating the work of a company's specialist would be greatest when the risk of material misstatement is high; the specialist's work is critical to the auditor's conclusion; the specialist has a lower level of knowledge, skill, and ability in the particular field; and the company has the ability to significantly affect the specialist's judgments. These factors are also illustrated in Figure 4, below.
Figure 4: Factors that Affect the Necessary Evidence

From the Auditor's Evaluation of the Company's Specialist's Work

Under the final amendments, the first two factors, in combination, relate to the persuasiveness of the evidence needed from the work of the company's specialist, as follows:

- **Risk of Material Misstatement.** Consistent with the risk assessment standards, under the final amendments, the higher the risk of material misstatement for an assertion, the more persuasive the evidence needed to support a conclusion about that assertion.84 Pursuant to existing PCAOB

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84 See paragraph .09a of AS 2301.
standards, tests of controls are required if the risk of material misstatement is based on reliance on controls.\textsuperscript{85}

- **Significance of the Specialist's Work.** The significance of the specialist's work refers to the degree to which the auditor would use the work of the company's specialist to support the auditor's conclusions about the assertion. Generally, the greater the significance of the specialist's work to the auditor's conclusion regarding the relevant assertion, the more persuasive the evidence from the specialist's work needs to be. The significance of the specialist's work stems from:
  - *The extent to which the specialist's work affects significant accounts and disclosures in the financial statements.* In some situations, the specialist's work might be used only as a secondary check for a significant account or disclosure, while in other situations that work might be a primary determinant in one or more significant accounts and disclosures in the financial statements.
  - *The auditor's approach to testing the relevant assertion.* When a company's accounting estimate is determined principally based on the work of a company's specialist, an auditor testing the company's process for developing the accounting estimate would plan to use the work of the company's specialist for evidence regarding the estimate. On the other hand, if the auditor tests an

\textsuperscript{85} See AS 2301.16, which addresses testing controls to modify the nature, timing, and extent of planned substantive procedures.
assertion by developing an independent expectation, the auditor would give less consideration to the work of the company's specialist.\textsuperscript{86}

The other two factors—the specialist's level of knowledge, skill, and ability, and the ability of the company to significantly affect the specialist's judgments—relate to the degree of reliability of the specialist's work as audit evidence (i.e., the extent to which the specialist's work could provide persuasive evidence, if relevant and found to be satisfactory after the auditor's evaluation).

In some situations, if the auditor has doubt about the specialist's knowledge, skill, and ability or about the company's effect on the specialist's judgments, the auditor might choose not to use the work of the company's specialist, instead of performing additional procedures with respect to evaluating the specialist's work. The final amendments do not preclude the auditor from pursuing other alternatives to using that specialist's work. Such alternatives might include developing an independent expectation of the related accounting estimate or seeking to use the work of another specialist.

The following examples illustrate various ways in which the factors discussed above can affect the necessary audit effort in evaluating the work of a company's specialist under the final amendments. The examples assume that the auditor will evaluate, as appropriate, the data, significant assumptions, and methods used by the

\textsuperscript{86} As another example, the auditor might develop an independent expectation using certain assumptions or methods of the company's specialist. In those instances, the auditor's evaluation would focus on those assumptions or methods that the auditor used in developing his or her independent expectation.
specialist, and evaluate the relevance and reliability of the work of the company's specialist and its relationship to the relevant assertion.

**Example 1** – An oil and gas production company employs an experienced petroleum reserve engineer to assist in developing the estimated proved oil and gas reserves\(^{87}\) that are used in multiple financial statement areas, including: (1) the company's impairment analysis; (2) depreciation, depletion and amortization calculations; and (3) related financial statement disclosures, such as reserve disclosures. A substantial portion of the engineer's compensation is based on company earnings, and the engineer has a reporting line to the company's chief financial officer. The auditor concludes that the risk of material misstatement of the valuation of oil and gas properties is high, and the reserve engineer's work is significant to the auditor's conclusion regarding the assertion. Thus, the auditor would need to obtain more persuasive audit evidence commensurate with a high risk of material misstatement, devoting more audit attention to the data, significant assumptions, and methods that are more important to the specialist's findings and more susceptible to error or significant management influence. On the other hand, relatively less audit evidence might be needed for the work of an individual reserve engineer if the company has several properties of similar risk, and the reserve studies are performed by different qualified reserve engineers who are either (1) engaged by the company, having no significant ties that give the company significant influence over the specialists' judgments or (2) employed specialists for which the company has implemented compensation policies.

\(^{87}\) See Rule 4-10(a)(22) of Regulation S-X, 17 CFR 210.4-10(a)(22).
reporting lines, and other measures to prevent company management from having significant influence over the specialists' judgments.

*Example 2* – A financial services company specializes in residential mortgage and commercial mortgage loans, which are either sold or held in its portfolio. During the financial statement audit, the auditor may inspect appraisals prepared by the company's specialists for the real estate collateralizing loans for a variety of reasons, including in conjunction with testing the valuation of loans and the related allowance for loan losses. Under these circumstances, the persuasiveness of the evidence needed from (and the necessary degree of audit attention devoted to evaluating the methods, significant assumptions, and data used in) an individual appraisal would depend, among other things, on the importance of the individual appraisal to the auditor's conclusion about the related financial statement assertion. In general, more audit attention would be needed for appraisals used in testing the valuation of individually large loans that are valued principally based on their collateral than for appraisals inspected in loan file reviews for a portfolio of smaller loans with a low risk of default and a low loan-to-value ratio.

*Example 3* – A manufacturing company engages an actuary to calculate the projected pension benefit obligation ("PBO") for its pension plan, which is used to determine the related accounts and disclosures in the financial statements. The auditor has assessed the risk of material misstatement for the valuation of the PBO as high and concluded that the actuary's work is significant to the auditor's conclusion. The actuary has extensive experience and is employed by a highly
regarded actuarial firm with many clients. The actuary and actuarial firm have no relationships with the company other than performing the actuarial pension plan calculations for the company's financial statements. Under these circumstances, the necessary level of audit attention is less than it otherwise would be for a situation where a specialist has a lower level of knowledge, skill and ability, or the company has the ability to significantly affect the specialist's judgments about the work performed, conclusions, or findings. When more audit attention is needed, the auditor would focus on those aspects of the specialist's work that could be affected by the issues related to the specialist's knowledge, skill, and ability or by the company's ability to significantly affect the specialist's judgments.

The three examples above are provided only to illustrate the auditor's consideration of the four factors set forth in the final amendments when determining the necessary audit effort for evaluating the work of the company's specialist. Differences in circumstances, or additional information, could lead to different conclusions. The examples are not intended to prescribe the specific procedures to be performed in evaluating the work of a company's specialist in any particular situation, which should be determined in accordance with the final amendments.

Evaluating the Specialist's Work: Findings

See AS 1105.A9–A10, as adopted

The Proposal set forth requirements for evaluating the relevance and reliability of the specialist's findings. The proposed requirements built upon the existing requirements
to evaluate the specialist's findings and were aligned with the risk assessment standards. The Proposal also provided factors that affect the relevance and reliability of the specialist's work. Additionally, the proposed requirements described examples of situations in which additional procedures ordinarily are necessary. Commenters on this aspect of the Proposal generally supported the proposed approach. A few commenters asked for an explanation of the additional procedures to be performed. One commenter stated that certain restrictions, disclaimers, or limitations are common in specialists' reports and that auditors may have no choice but to accept them.

After considering the comments received, the Board is adopting the requirements as proposed with one modification discussed below. The final requirements in AS 1105.A10, as adopted, provide that the auditor should perform additional procedures, as necessary, if the specialist's findings or conclusions appear to contradict the relevant assertion or the specialist's work does not provide sufficient appropriate evidence. The final requirements also provide examples of situations in which additional procedures ordinarily are necessary, such as when the specialist's report, or equivalent communication, contains restrictions, disclaimers, or limitations regarding the auditor's

88 Existing AS 1210.12 requires the auditor to evaluate whether the specialist's findings support the related assertions in the financial statements. It does not specify, however, what might lead an auditor to conclude that he or she should perform additional procedures or obtain the opinion of another specialist.

89 AS 1105.A9–A10, as adopted, added the phrase "or equivalent communication," which was not part of the proposed amendments, because a company's specialist may communicate his or her findings or conclusions in a memorandum or other written alternative to a formal report. AS 1201, Appendix C, as adopted, and AS 1210, as amended, refer to a specialist's report "or equivalent documentation." The difference in terminology is intended to distinguish information provided by the auditor's specialist from information provided by the company's specialist.
The use of the report or the auditor has identified that the specialist has a conflict of interest relevant to the specialist's work. The final requirements do not prescribe specific procedures to be performed because the necessary procedures depend on the circumstances creating the need for the procedures.

A specialist's report may contain restrictions, disclaimers, or limitations that cast doubt on the relevance and reliability of the information contained in the specialist's report and affect how the auditor can use the report of the specialist. For example, a specialist's report that states "the values in this report are not an indication of the fair value of the underlying assets" generally would not provide sufficient appropriate evidence related to fair value measurements. On the other hand, a specialist's report that indicates that the specialist's calculations were based on information supplied by management may still be appropriate for use by the auditor to support the relevant assertion, since the auditor would already be required to test the company-supplied data used in the specialist's calculations.

The requirements in AS 1105.A10, as adopted, do not require the auditor to perform procedures specifically to search for potential conflicts of interest that a company's specialist might have, other than those resulting from the specialist's relationship with the company. However, the auditor may become aware of conflicts of interest arising from relationships with parties outside the company (e.g., through obtaining information about the specialist's professional reputation and standing, reading the specialist's report, or performing procedures in other audit areas). For example, in reviewing an appraisal of the collateral for a material loan receivable, the auditor may become aware that the appraiser has a substantial financial interest in the collateral. If the
auditor becomes aware of a conflict of interest that could affect the specialist's judgments about the work performed, conclusions, or findings, the auditor would need to consider the effect of that conflict on the reliability of the specialist's work, and perform additional procedures if necessary to obtain sufficient appropriate evidence regarding the relevant financial statement assertion.

**Comparison with Standards of Other Standard Setters**

Paragraph 8(c) of ISA 500 provides that, if information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary and having regard to the significance of that expert's work for the auditor's purposes, evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.

AU-C Section 500 contains requirements that are similar to those in ISA 500.

**Amendments Related to Supervising or Using the Work of an Auditor's Specialist**

The final amendments set forth requirements for supervising or using the work of an auditor's specialist, taking into account differences in the auditor's relationship with employed specialists and engaged specialists. A new appendix to AS 1201 applies to the supervision of auditor-employed specialists, and AS 1210, as amended, applies when using the work of auditor-engaged specialists.

Commenters on the Proposal generally supported the proposed approach for overseeing and coordinating the work of an auditor's specialists, which was risk-based and set forth largely parallel requirements when using the work of both auditor-employed and auditor-engaged specialists. A few commenters, however, expressed concerns with
the practicality and clarity of certain aspects of the proposed requirements. These comments and others are discussed below.

*Amendments to AS 1201 for Supervising the Work of an Auditor-Employed Specialist*

Appendix C of AS 1201, as adopted, supplements the existing requirements in AS 1201.05–.06 by providing more specific direction on applying the general supervisory principles in AS 1201 to the supervision of an auditor-employed specialist who assists the auditor in obtaining or evaluating audit evidence.

**Meaning of "Auditor-Employed Specialist"**

*See AS 1201.C1, as adopted*

The Proposal used the term "auditor-employed specialist" to mean a "specialist employed by the auditor's firm," consistent with existing requirements. Two commenters asked for clarification of how to apply the terms "auditor-employed" and "auditor-engaged" specialists when specialists are employed by entities that are affiliated with the audit firm and those specialists are subject to the same quality control policies and procedures and independence requirements as employees of the audit firm.

The final amendments retain the existing concept that an "auditor-employed specialist" is a "specialist employed by the auditor's firm." Given that the terms "auditor-employed specialist" and "auditor-engaged specialist" in the final amendments are consistent with existing requirements, auditors should be familiar with this distinction. The Board recognizes, however, that there may be instances where an auditor uses the work of a specialist who is a partner, principal, shareholder or employee of an affiliated

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90 See existing AS 1210.05, which states that AS 1201 applies to situations in which "a specialist employed by the auditor's firm participates in the audit."
entity that is not an accounting firm and treats that specialist as if he or she were employed by the auditor's firm (i.e., as an auditor-employed specialist). While it is not practicable to address all the legal structures or affiliations between accounting firms and specialist entities that may give rise to such situations, the final amendments are not intended to change current practice where the specialist is employed by an affiliated entity that adheres to the same quality control and independence requirements as the auditor's firm. In such circumstances, the Board understands that the auditor would assess the qualifications and independence of that specialist in the same ways as an engagement team member employed by the firm.

**Comparison with Standards of Other Standard Setters**

ISA 620 covers the auditor's use of the work of both auditor-employed experts and auditor-engaged experts, but the requirements in ISA 620 for the auditor's evaluation of the objectivity of an auditor-employed expert differ from those for evaluating the objectivity of an auditor-engaged expert.

AU-C Section 620 is similar to ISA 620 in both respects.

**Determining the Extent of Supervision**

See AS 1201.C2, as adopted

The Proposal supplemented, in proposed Appendix C of AS 1201, the factors set forth in AS 1201.06 for determining the necessary extent of supervision of engagement team members in circumstances involving the use of the work of an auditor-employed specialist.\(^\text{91}\)

\[^{91}\] AS 1201.06 provides that, to determine the extent of supervision necessary for engagement team members, the engagement partner and other engagement team
No commenters opposed the proposed requirement for determining the extent of supervision. One commenter stated that the proposed requirement for determining the extent of supervision appeared scalable to the size and complexity of the audit engagement. The Board is adopting this requirement as proposed. The final requirements provide that the necessary extent of supervision depends on: (1) the significance of the specialist's work to the auditor's conclusion regarding the relevant assertion; (2) the risk of material misstatement of the relevant assertion; and (3) the knowledge, skill, and ability of the auditor-employed specialist relevant to the work to be performed by the specialist.

**Comparison with Standards of Other Standard Setters**

Paragraph 8 of ISA 620 provides that, depending on the circumstances, the nature, timing and extent of the auditor's procedures will vary with respect to: (1) evaluating the competence, capabilities and objectivity of the auditor's expert; (2) obtaining an understanding of the field of expertise of the auditor's expert; (3) reaching an agreement with the auditor's expert; and (4) evaluating the adequacy of the auditor's expert's work. In determining the nature, timing and extent of those procedures, the auditor shall consider matters including:

(a) The nature of the matter to which that expert's work relates;
(b) The risks of material misstatement in the matter to which that expert's work relates;

members performing supervisory activities should take into account, among other things: (1) the nature of the company, including its size and complexity; (2) the nature of the assigned work for each engagement team member; (3) the risks of material misstatement; and (4) the knowledge, skill, and ability of each engagement team member.
(c) The significance of that expert's work in the context of the audit;

(d) The auditor's knowledge of and experience with previous work performed by that expert; and

(e) Whether that expert is subject to the auditor's firm's quality control policies and procedures.

AU-C Section 620 contains requirements that are similar to those in ISA 620.

Qualifications and Independence of Auditor-Employed Specialists

See AS 1015.06, as amended, and footnote 3A to AS 2101.06b, as amended

PCAOB auditing standards require that personnel be assigned to engagement teams based on their knowledge, skill, and ability. This requirement applies equally to auditor-employed specialists and other engagement team members. In addition, auditor-employed specialists must be independent of the company. Accordingly, the requirements in PCAOB auditing standards for determining compliance with independence and ethics requirements apply to auditor-employed specialists. Rather than add specific requirements for evaluating the qualifications and independence of

92 See AS 2301.05a and AS 1015.06, as amended.

93 PCAOB Rule 3520, Auditor Independence, requires a registered public accounting firm and its associated persons to be independent of the firm's "audit client" throughout the audit and professional engagement period, meaning that they must satisfy all independence criteria applicable to an engagement. In addition, under Rule 2-01 of Regulation S-X, 17 CFR §210.2-01, any professional employee of the "accounting firm" (as broadly defined in Rule 2-01(f)(2) to include associated entities) who participates in an engagement of an audit client is a member of the "audit engagement team," as that term is defined under Rule 2-01(f)(7)(i). The effect is that an accounting firm is not independent if it uses the work of a specialist employed by the accounting firm who does not meet the independence requirements of Rule 2-01.

94 See AS 2101.06b.
auditor-employed specialists, the Proposal would have included two paragraphs in Appendix C citing the applicable requirements in existing standards.\footnote{See proposed AS 1201.C3–C4; see also AS 2301.05a, AS 1015.06, and AS 2101.06b.}

Most commenters on this topic advocated for greater acknowledgment of the auditor's ability to use information from the firm's system of quality control when assessing the knowledge, skill, ability, and independence of an auditor-employed specialist. Specifically, some of these commenters recommended the inclusion of references to QC 20, \textit{System of Quality Control for a CPA Firm's Accounting and Auditing Practice} ("QC 20"), in these requirements. In the view of these commenters, QC 20 more fully encompasses both the considerations related to the appropriate assignment of personnel to an engagement and the requirements related to independence, integrity, and objectivity. One commenter suggested that the standard provide that a firm's system of quality control pursuant to QC 20 would be sufficient to satisfy the requirements relating to the qualifications and independence of auditor-employed specialists. Another commenter stated that the necessary guidance was contained in QC 20 and that the references in the Proposal to applicable requirements in existing standards were duplicative.

The Board considered these comments in adopting the final amendments. The intent of the proposed paragraphs for assigning personnel based on their knowledge, skill, and ability, and for determining compliance with independence and ethics requirements, was to emphasize that auditors' responsibilities for assessing the qualifications and independence of the auditor-employed specialists are the same as for other engagement
team members. To avoid any misunderstanding that a different process was expected for assigning auditor-employed specialists and determining their compliance with independence and ethics requirements, the proposed paragraphs do not appear in the final amendments. Also, two related amendments to PCAOB auditing standards are being adopted. First, AS 1015.06 has been amended to clarify that engagement team members, which includes auditor-employed specialists, should be assigned to tasks and supervised commensurate with their level of knowledge, skill, and ability, and that this requirement is not limited to the assignment and supervision of auditors. Second, in another conforming amendment, a footnote was added to AS 2101.06b to remind auditors of the obligations of registered firms and their associated persons under PCAOB Rule 3520.

Under the final amendments, auditors will continue to have the ability to use information from, and processes in, the firm's quality control system when assessing the knowledge, skill, ability, and independence of auditor-employed specialists. The fact that a system of quality control may have a process for making assignments of specialists does not relieve the engagement partner (with the assistance of appropriate supervisory personnel on the engagement team) of his or her responsibility to determine whether the assigned specialist has the necessary qualifications and independence for the particular audit engagement in accordance with AS 1015.06, as amended, and AS 2101.06, as amended. The relevant facts and circumstances, including the nature, scope, and objectives of the specialist's work, should be considered when performing this assessment. For example, a valuation specialist may have expertise in valuing oil and gas reserves, but not in valuing coal reserves. In that case, failure to consider the specialist's expertise when assigning the specialist work on an audit engagement in an extractive
industry could result in the inappropriate assignment of significant engagement responsibilities.

**Comparison with Standards of Other Standard Setters**

Paragraph 9 of ISA 620 provides that the auditor shall evaluate whether the auditor's expert has the necessary competence, capabilities, and objectivity for the auditor's purposes.

AU-C Section 620 contains requirements that are similar to those in ISA 620.

**Informing the Specialist of the Work to be Performed**

See AS 1201.C3–C5, as adopted

The Proposal supplemented the requirements in PCAOB standards for informing the engagement team members of their responsibilities to address situations where auditor-employed specialists are performing work in an audit. Most commenters who commented on the supplemental requirements generally supported the proposed approach, asserting that it would foster effective communication between the auditor and the auditor's specialist. Some commenters, however, asked for clarification of certain aspects of the proposed requirement to establish and document an understanding with the specialist of the work to be performed. After considering the comments received, the Board is adopting the requirements substantially as proposed.

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96 AS 1201.05a sets forth requirements for the engagement partner and, as applicable, other engagement team members performing supervisory activities to inform engagement team members of their responsibilities. These matters include: (1) the objectives of the procedures that engagement team members are to perform; (2) the nature, timing, and extent of procedures they are to perform; and (3) matters that could affect the procedures to be performed or the evaluation of the results of those procedures, including relevant aspects of the company, its environment, and its internal control over financial reporting, and possible accounting and auditing issues.
The final amendments include requirements for the engagement partner and, as applicable, other engagement team members performing supervisory activities to inform the auditor-employed specialist about the work to be performed. These requirements include establishing and documenting an understanding with the specialist regarding the responsibilities of the specialist, the nature of the specialist's work, the specialist's degree of responsibility for testing data and evaluating methods and significant assumptions, and the responsibility of the specialist to provide a report, or equivalent documentation.

Some commenters requested clarification in the final amendments on the form of documentation of the auditor's understanding with the specialist. In addition, some commenters suggested removing the specific reference to the specialist's responsibility to provide a "report, or equivalent documentation" and allowing for more flexibility when the specialist's results are communicated to the auditor. Some of these commenters asserted that the proposed requirement connoted the preparation of a formal, signed report, which could discourage effective two-way communication between the auditor and the specialist. Another commenter suggested that the Board consider whether the auditor's understanding with the specialist should also include matters the specialist should communicate to the auditor, and the nature, timing, and extent of those communications. One commenter also expressed concern that use of the term "degree of responsibility" could be seen as a means for auditors to abdicate responsibility for audit work to specialists.

The final amendments do not include specific requirements for how to document the auditor's understanding with the auditor's specialist. Instead, the Board contemplates that the understanding with the specialist can be documented in a variety of ways, such as
in planning memoranda, separate memoranda, or other related work papers. This approach should provide auditors with flexibility, while still requiring the documentation of the important aspects of the understanding reached by the auditor and the auditor's specialist. This approach also enables the specialist to communicate those matters specific to the work performed and does not limit the specialist's ability to communicate other items to the auditor.

The final amendments also require the auditor to establish and document an understanding with the specialist regarding the degree of responsibility of the specialist for: (1) testing data produced by the company, or evaluating the relevance and reliability of data from sources external to the company; (2) evaluating the significant assumptions used by the company or the company's specialist, or developing his or her own assumptions; and (3) evaluating the methods used by the company or the company's specialist, or using his or her own methods. The intent of this requirement is to enhance coordination of the work between the auditor and the auditor's specialist and facilitate supervision of the specialist by the engagement partner and others with supervisory responsibilities. For example, if the auditor's specialist assists the auditor in developing an independent expectation using data, assumptions, or a model provided by the auditor or auditor's specialist, the auditor would establish an understanding with the specialist regarding the specialist's responsibilities with respect to the data, assumptions, or model.\textsuperscript{97} Regardless of the specialist's degree of responsibility, the engagement partner

\textsuperscript{97} AS 1201.C5, as adopted, provides that the auditor should comply with AS 2501.21–.26, as adopted, when an independent expectation is developed. For example, the auditor’s responsibilities with respect to using data or assumptions obtained from a third party are presented in AS 2501.23, as adopted. See Estimates Release, supra.
and, as applicable, other engagement team members performing supervisory activities are responsible for evaluating the specialist's work and report, or equivalent documentation.\textsuperscript{98}

In addition, as proposed, the final amendments require establishing and documenting the specialist's responsibility to provide "a report, or equivalent documentation" to the auditor. This requirement should provide flexibility for auditors to obtain the necessary information about the specialist's procedures, findings, and conclusions through the specialist's report, other specialist-provided documentation, or a combination of the two. The requirement should also facilitate the auditor's compliance with other PCAOB auditing standards, such as those on engagement quality review and audit documentation.\textsuperscript{99}

The final amendments require establishing and documenting the auditor's understanding with the specialist regarding the "nature of the work that the specialist is to perform or assist in performing." As proposed, this requirement would have also encompassed the "specialist's approach to that work." Two commenters suggested that the Board clarify the difference between the two terms. The nature of the specialist's work would include, for example, testing data and evaluating the methods and significant assumptions used in developing an estimate when testing the company's process used to develop an accounting estimate or developing an independent expectation of an estimate. The specialist's approach to that work, in turn, might include the procedures the specialist

\textsuperscript{note 20.}

\textsuperscript{98} See AS 1201.C6-.C7, as adopted.

\textsuperscript{99} See AS 1220, Engagement Quality Review, and AS 1215, Audit Documentation.
performs to test management's process or develop an independent expectation, such as testing data and evaluating the methods and significant assumptions used in developing an estimate. Since the auditor's obligation to establish and document the specialist's degree of responsibility for performing similar procedures is addressed in other provisions of the final amendments, the phrase "the specialist's approach to that work" has been omitted to avoid potential confusion.

As proposed, the final amendments also provide that, pursuant to AS 1201.05a(3), the engagement partner and, as applicable, other engagement team members performing supervisory activities should inform the auditor-employed specialist about matters that could affect the specialist's work. This includes, as applicable, information about the company and its environment, the company's processes for developing the related accounting estimate, the company's use of specialists in developing the estimate, relevant requirements of the applicable financial reporting framework, possible accounting and auditing issues, and the need to apply professional skepticism. Commenters did not offer suggestions on this provision, although one commenter stated that it concurred with the proposed requirement.

The final amendments also provide that the engagement partner and, as applicable, other engagement team members performing supervisory activities should implement measures to determine that there is a proper coordination of the work of the specialist with the work of other relevant engagement team members to achieve a proper evaluation of the evidence obtained in reaching a conclusion about the relevant

100 See AS 1201.C3c, as adopted.

101 See AS 1201.C4, as adopted.
assertion. One commenter requested clarification of the term "measures," as used in this context. The final requirement emphasizes that the auditor is responsible for complying with relevant auditing standards, including, when applicable, AS 2501, as adopted, and Appendix A of AS 1105, as adopted. This requirement is intended to prompt the auditor to coordinate with the specialist to make sure that the work is performed in accordance with the applicable standards, including the requirement to consider relevant audit evidence, regardless of whether it supports or contradicts the relevant financial statement assertion. For example, in auditing an accounting estimate under AS 2501, as adopted, measures taken by the auditor could include either performing, or supervising the auditor's specialist in performing, the required procedures with respect to testing and evaluating the data, and evaluating the methods and significant assumptions used in developing that estimate.

Comparison with Standards of Other Standard Setters

Paragraph 11 of ISA 620 provides that the auditor shall agree, in writing when appropriate, on the following matters with the auditor's expert:

(a) The nature, scope and objectives of that expert's work;

(b) The respective roles and responsibilities of the auditor and that expert;

\[^{102}\] See AS 1201.C5, as adopted.

\[^{103}\] See AS 1201.C5, as adopted. In response to comments, this paragraph was revised in the final amendments to provide that, if an auditor's specialist is used to evaluate the work of a company's specialist, measures should be implemented to comply with Appendix A of AS 1105, as adopted, and, for accounting estimates, AS 2501.19, as adopted.

\[^{104}\] See AS 2501, as adopted, and Estimates Release, supra note 20.
(c) The nature, timing, and extent of communication between the auditor and that expert, including the form of any report to be provided by that expert; and

(d) The need for the auditor's expert to observe confidentiality requirements.

AU-C Section 620 contains requirements that are similar to those in ISA 620.

Evaluating the Work of the Specialist

See AS 1201.C6–C7, as adopted

The Proposal supplemented, in Appendix C, the requirements in AS 1201.05c for reviewing the work of the engagement team in circumstances in which auditor-employed specialists are used.\(^{105}\) It provided that, if the specialist's findings or conclusions appear to contradict the relevant assertion or the specialist's work does not provide sufficient appropriate evidence, the engagement partner and, as applicable, other engagement team members performing supervisory activities should perform additional procedures, or request the specialist to perform additional procedures, as necessary to address the issue.

Commenters generally agreed with these requirements, noting that the requirements are appropriate and, in the view of some commenters, would improve audit quality. Two commenters asked for additional guidance on how the auditor should evaluate methods and assumptions used by an auditor-employed specialist. One commenter recommended providing additional guidance on the specific procedures to be performed.

\(^{105}\) AS 1201.05c provides that the engagement partner and, as applicable, other engagement team members performing supervisory activities should review the work of engagement team members to evaluate whether: (1) the work was performed and documented; (2) the objectives of the procedures were achieved; and (3) the results of the work support the conclusions reached.
performed by auditors to evaluate a specialist's work. After considering the comments, the Board is adopting the requirements substantially as proposed.

The final amendments provide a principles-based framework for reviewing and evaluating the work of the specialist. Under the final amendments, the engagement partner and, as applicable, other engagement team members performing supervisory activities should review the specialist's report or equivalent documentation describing the work performed, the results of the work, and the findings or conclusions reached by the specialist, as provided for under AS 1201.C3d, as adopted.106

This approach links the scope of the auditor's review to the report or equivalent documentation that the specialist agreed to furnish to the auditor under AS 1201.C3, as adopted. The principles for the necessary extent of supervision, discussed earlier, also apply to evaluating the work of the auditor-employed specialist, including the report or equivalent documentation provided by the specialist. Accordingly, auditors should be familiar with this approach and how to apply this requirement in practice.

The necessary extent of review and evaluation of the auditor-employed specialist's work depends on (1) the significance of the specialist's work to the auditor's conclusion regarding the relevant assertion; (2) the risk of material misstatement of the relevant assertion; and (3) the knowledge, skill, and ability of the specialist. In performing the review, the auditor also should evaluate whether the specialist's work provides sufficient appropriate evidence, specifically whether:

\[106\] *See* AS 1201.C6, as adopted.
• The specialist's work and report, or equivalent documentation, are in accordance with the auditor's understanding with the specialist; and

• The specialist's findings and conclusions are consistent with results of the work performed by the specialist, other evidence obtained by the auditor, and the auditor's understanding of the company and its environment.

AS 1201.C7, as adopted, provides that, if the specialist's findings or conclusions appear to contradict the relevant assertion or the specialist's work does not provide sufficient appropriate evidence, the engagement partner and, as applicable, other engagement team members performing supervisory activities should perform additional procedures, or request the specialist to perform additional procedures, as necessary to address the issue. The final requirement also provides examples of situations in which additional procedures ordinarily would be necessary, including:

• The specialist's work was not performed in accordance with the auditor's instructions;

• The specialist's report, or equivalent documentation, contains restrictions, disclaimers, or limitations that affect the auditor's use of the report or work;\(^{107}\)

• The specialist's findings and conclusions are inconsistent with (1) the results of the work performed by the specialist, (2) other evidence

\(^{107}\) The auditor's consideration of restrictions, disclaimers, or limitations in a report, or equivalent documentation, provided by an auditor-employed specialist is the same as when such language is contained in a report, or equivalent documentation, provided by an auditor-engaged specialist. See below for further discussion of the auditor's consideration of the effect of restrictions, disclaimers, or limitations on the report, or equivalent documentation, provided by the auditor-engaged specialist.
obtained by the auditor, or (3) the auditor's understanding of the company and its environment;

- The specialist lacks a reasonable basis for data or significant assumptions the specialist used; or
- The methods used by the specialist were not appropriate.

These requirements are consistent with existing provisions in paragraphs .06 and .36 of AS 2810, *Evaluating Audit Results*, which provide that, if the auditor concludes that the evidence gathered is not adequate, he or she should modify his or her audit procedures or perform additional procedures as necessary (e.g., audit procedures may need to be modified or additional procedures may need to be performed as a result of any changes in the risk assessments). Similarly, if the evidence gathered by the specialist in testing or evaluating data, or evaluating significant assumptions is not adequate, the engagement partner and, as applicable, other engagement team members performing supervisory activities should perform additional procedures, or request the specialist to perform additional procedures, as necessary to address the issue.

One commenter asserted that auditors may not have sufficient knowledge of the specialist's field of expertise to evaluate a specialist's work and effectively challenge methods, assumptions, and data, particularly in relation to highly complex technical areas. The final amendments recognize that the engagement partner and, as applicable, other engagement team members performing supervisory responsibilities may not have in-depth knowledge of the specialist's field. However, under existing PCAOB standards, the auditor is required to have sufficient knowledge of the subject matter to evaluate a specialist's work as it relates to the nature, timing, and extent of the auditor's work and
the effects on the auditor's report.\textsuperscript{108} Furthermore, the evaluation of the specialist's work under the final amendments is based on matters that are within the capabilities of the auditor (e.g., whether the specialist followed instructions and whether the results of the work support the specialist's conclusions).

Another commenter asked for clarification of the term "reasonable basis" in the context of assessing whether the specialist lacks a reasonable basis for data or significant assumptions the specialist used. In that context, "reasonable basis" refers to whether the specialist's selection of data or significant assumptions was determined arbitrarily or instead based on consideration of relevant information available to the specialist.

Comparison with Standards of Other Standard Setters

Paragraph 12 of ISA 620 provides that the auditor shall evaluate the adequacy of the auditor's expert's work for the auditor's purposes, including:

(a) The relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence;

(b) If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods in the circumstances; and

(c) If that expert's work involves the use of source data that is significant to that expert's work, the relevance, completeness, and accuracy of that source data.

\textsuperscript{108} See AS 2101.17.
Paragraph 13 of ISA 620 provides that if the auditor determines that the work of the auditor's expert is not adequate for the auditor's purposes, the auditor shall:

(a) Agree with that expert on the nature and extent of further work to be performed by that expert; or

(b) Perform additional audit procedures appropriate to the circumstances.

AU-C Section 620 contains requirements that are similar to those in ISA 620.

Amendments to Existing AS 1210 for Using the Work of an Auditor-Engaged Specialist

This section discusses the final requirements in AS 1210, as amended, for audits in which the auditor uses an auditor-engaged specialist. In such circumstances, the objective of the auditor is to determine whether the work of the auditor-engaged specialist is suitable for the auditor's purposes and supports the auditor's conclusion regarding the relevant assertion.

Assessing the Knowledge, Skill, Ability, and Objectivity of the Engaged Specialist

As described above, existing AS 1210 requires the auditor to evaluate the professional qualifications of a specialist and the relationship of a specialist to the company.

Similar to the final amendments related to using a company's specialist, the final amendments carry forward the existing requirements with certain modifications described below.

Knowledge, Skill, and Ability

See AS 1210.03–.04, as amended

Requirements in existing AS 1210 related to the auditor's evaluation of a specialist's qualifications were described above with regard to a company's specialist.
These requirements are the same for a company's specialist and an auditor-engaged specialist.

The Proposal substantially carried forward the requirement in existing AS 1210. Unlike the existing standard, however, the Proposal expressly provided that the auditor would obtain an understanding of the professional qualifications of both the specialist and the entity that employs the specialist. The Board is adopting this requirement as proposed.

Two commenters concurred with the proposed approach to assessing knowledge, skill, and ability of the auditor-engaged specialist. One commenter suggested allowing auditors to assess the specialist's knowledge, skill, and ability centrally as part of the firm's system of quality control. Another commenter asserted that the proposed requirement was not well-suited to assessing the knowledge, skill, and ability of the entity that employs the specialist.

Under the final amendments, auditors will continue to be able to use information from, and processes in, the firm's quality control system when assessing the knowledge, skill, and ability of auditor-engaged specialists. The fact that a system of quality control may have a firm-level process for screening engaged specialists does not relieve the engagement partner (with the assistance of appropriate supervisory personnel on the engagement team) of his or her responsibility to assess whether the engaged specialist has the necessary knowledge, skill, and ability for the particular audit engagement. The relevant facts and circumstances, including the nature, scope, and objectives of the specialist's work, should be considered when performing this assessment.

The final requirement retains the concept in existing AS 1210 that a specialist
may be an individual or an entity. Outreach to audit firms suggests that firms have policies and procedures for evaluating the qualifications of specialists, whether individuals or entities. Accordingly, auditors should be familiar with assessing the qualifications of entities that are specialists or employ specialists. Therefore, the final requirement is not expected to result in a significant change in practice.

AS 1210, as amended, does not specify steps to perform or information sources to use in assessing the specialist's knowledge, skill, and ability. Potential sources of relevant information, if available, could include the following:

- Information contained within the audit firm related to the professional qualifications and reputation of the specialist and the entity that employs the specialist, if applicable, in the relevant field and experience with previous work of the specialist;
- Professional or industry associations and organizations, which may provide information on: (1) qualification requirements, technical performance standards, and continuing professional education requirements that govern their members; (2) the specialist's education and experience, certification, and license to practice; and (3) recognition of, or disciplinary actions taken against the specialist;
- Information provided by the specialist about matters regarding the specialist's understanding of the financial reporting framework, experience in performing similar work, and the methods and assumptions used in the specialist's work the auditor plans to evaluate;
• The specialist's responses to questionnaires about the specialist's professional credentials; and

• Published books or papers written by the specialist.

Requirements applicable to a specialist pursuant to legislation or regulation also could help inform the auditor's assessment of the specialist's knowledge, skill, and ability.

The purpose of the assessment of the auditor-engaged specialist's knowledge, skill, and ability is two-fold: (1) to determine whether the specialist possesses a sufficient level of knowledge, skill, and ability to perform his or her assigned work; and (2) to help determine the necessary extent of the review and evaluation of the specialist's work. AS 1210.04, as amended, emphasizes the importance of engaging a sufficiently qualified auditor's specialist by expressly providing that the auditor should not use the work of an engaged specialist who does not have a sufficient level of knowledge, skill, and ability.

The assessment of the specialist's knowledge, skill, and ability by the engagement partner and, as applicable, other engagement team members performing supervisory activities is also a factor when determining the necessary extent of the review and evaluation of the specialist's work. The auditor's evaluation of the work of a specialist may be more extensive if the specialist generally has sufficient knowledge, skill, and ability in the relevant field of expertise, but less experience in the particular area of specialty within the field. For example, a valuation specialist may possess sufficient knowledge, skill, and ability in business valuation, but may not be well-versed in the application of business valuation for financial reporting purposes.

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109 See AS 1210.10, as amended.
Objectivity

See AS 1210.05 and .11, as amended

Requirements in existing AS 1210 related to the auditor’s evaluation of a specialist's objectivity are described above with regard to a company's specialist. Those requirements are the same for a company's specialist and an auditor-engaged specialist.

The Proposal built on the requirements for assessing objectivity in the existing standard and provided that the engagement partner and, as applicable, other engagement team members performing supervisory activities would assess whether the specialist and the entity that employs the specialist have the necessary objectivity, which includes evaluating whether the specialist or the entity that employs the specialist has a relationship to the company (e.g., through employment, financial, ownership, or other business relationships, contractual rights, family relationships, or otherwise), or any other conflicts of interest relevant to the work to be performed.

The proposed requirements differed from the existing requirements in two primary respects. First, they articulated the concept of objectivity for purposes of proposed AS 1210, as referring to the specialist's ability "to exercise impartial judgment on all issues encompassed by the specialist's work related to the audit." Second, they expanded the list of matters that the auditor would consider in assessing objectivity to include financial and business relationships with the company and other conflicts of interest.

Some commenters supported the proposed approach. Other commenters expressed concern that the proposed requirement implied that the assessment of whether the specialist had the necessary objectivity was a binary decision. These commenters
expressed a preference for describing objectivity as an attribute that exists along a spectrum. Some of these commenters asserted that an auditor should not be precluded from using the work of a less objective specialist, as long as the auditor performed additional procedures in those circumstances.

After considering the comments received, the requirement has been revised to allow auditors to assess the specialist's level of objectivity along a spectrum and use the work of a less objective specialist if the auditor performs additional procedures to evaluate the specialist's work. In revising this requirement, the Board took into account the need for auditors to assess the objectivity of auditor-engaged specialists, while allowing auditors, where appropriate, to engage specialists who have certain relationships with a company that may raise questions as to their level of objectivity.

The final amendments also require the auditor to perform procedures that are commensurate with, among other things, an engaged specialist's degree of objectivity. Under the final amendments, if the specialist or the entity that employs the specialist has a relationship with the company that affects the specialist's objectivity, the auditor should (1) perform additional procedures to evaluate the data, significant assumptions, and methods that the specialist is responsible for testing, evaluating, or developing consistent with the understanding established with the specialist pursuant to AS 1210.06, as amended, or (2) engage another specialist. The necessary nature and extent of the additional procedures would depend on the degree of objectivity of the specialist. As the degree of objectivity increases, the evidence needed from additional procedures

\[110\] See first note to AS 1210.05, as amended. See also AS 1210.10, as amended, for a description of other factors affecting the necessary extent of the auditor's review.
If the specialist has a low degree of objectivity, the auditor should apply the procedures for evaluating the work of a company's specialist. For example, if the specialist's employer has a significant ownership interest in the company, the specialist's ability to exercise objective and impartial judgment might be low and, therefore, the auditor should evaluate the data, significant assumptions, and methods used by the specialist under the requirements in Appendix A of AS 1105, as amended.

Some commenters on the Proposal suggested the Board should provide additional guidance to specify the steps to be performed by auditors to assess the objectivity of an auditor-engaged specialist, as well as what constitutes sufficient appropriate evidence to support this assessment. One commenter asserted that auditors would face challenges in assessing the objectivity of the entity that employs the specialist, as required under the Proposal, and suggested that auditors may be unable to obtain the policies, procedures, and systems, if any, of the entity employing the specialist. This commenter suggested either omitting the requirement to consider the objectivity of the specialist's employer or limiting the requirement to performing inquiry of the specialist.

After considering these comments, the Board has eliminated the assessment of the objectivity of the entity that employs the specialist as a separate requirement under the final requirements. Instead, the auditor is required to evaluate relationships between the company and both the specialist and the specialist's employer to determine whether either

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111 See AS 1210.11, as amended.

112 The concept of a "low degree of objectivity" is used in paragraph .18 of AS 2201, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements, and, therefore, should be familiar to auditors.

113 See AS 1210.11, as amended.
has a relationship with the company that may adversely affect the specialist's objectivity.\textsuperscript{114} This is consistent with existing AS 1210, under which a specialist may be either an individual or an entity. Additionally, outreach to specialist entities and audit firms suggests that audit firms have policies and procedures for evaluating relationships between a specialist entity that they engage and the company. Accordingly, the concept of assessing relationships between a company and an entity that employs specialists should be familiar to auditors.

As under the Proposal, the final amendments do not prescribe the procedures the auditor must perform to obtain information relevant to the auditor's assessment. In response to questions raised by commenters, the Board added a note to clarify that the evidence necessary to assess the specialist's objectivity depends on the significance of the specialist's work and the related risk of material misstatement.\textsuperscript{115} Under this principles-based approach, as the significance of the specialist's work and the risk of material misstatement increase, the persuasiveness of the evidence the auditor should obtain for this assessment also increases.

In addition, the note includes non-exclusive examples of potential sources of information that could be relevant to the auditor's assessment of the relationship to the company of both the specialist and the specialist's employer.\textsuperscript{116} These examples include

\textsuperscript{114} See AS 1210.05, as amended. For example, the specialist's employer might have an ownership or other financial interest with respect to the company, or other business relationships that might be relevant to the auditor's assessment of the specialist's ability to exercise objective and impartial judgment.

\textsuperscript{115} See second note to AS 1210.05, as amended.

\textsuperscript{116} Id. These examples were based on examples set forth in the Proposal, but have been refined to better reflect their application in practice.
responses to questionnaires provided to the specialist regarding relationships between the specialist, or the specialist's employer, and the company. As with the auditor's assessment of a specialist's knowledge, skill, and ability, certain sources of information may provide more persuasive evidence than others. In situations where more persuasive evidence is required, it may be appropriate to perform procedures to obtain evidence from multiple sources.

Comparison with Standards of Other Standard Setters

Paragraph 9 of ISA 620 provides that in the case of an auditor's external expert, the evaluation of objectivity shall include inquiry regarding interests and relationships that may create a threat to that expert's objectivity.

AU-C Section 620 contains requirements that are similar to those in ISA 620.

Informing the Specialist of the Work to be Performed, Determining the Extent of Review, and Evaluating the Work of the Specialist

See AS 1210.06–12, as amended

As is the case with respect to an auditor-employed specialist, the auditor uses an auditor-engaged specialist to assist the auditor in obtaining and evaluating audit evidence. Given the similar role of an auditor-employed and an auditor-engaged specialist in the audit, the final requirements for the auditor-engaged specialist are parallel to the requirements for the auditor-employed specialist when determining the extent of the auditor's review, informing the auditor-engaged specialist of the work to be performed, and evaluating the work of the auditor-engaged specialist. These final requirements are discussed in additional detail above.
Some commenters on the Proposal commented on the impact of certain proposed changes solely with respect to auditor-engaged specialists. These comments are discussed below.

One commenter on the Proposal expressed concern that the auditor may have limited access to proprietary models used by auditor-engaged specialists. This commenter recommended that the Board include statements made in the Proposal regarding the auditor's access to such models and the impact on the auditor's performance obligations in the final amendments. Similar to the Proposal, the final amendments do not require the auditor to have full access to a specialist's proprietary model or to reperform the work of the specialist, but instead require the auditor to evaluate the work of that specialist in accordance with the final standard. Under AS 1210.10, as amended, the necessary extent of the evaluation of the specialist's work, including a determination of the necessary access to a specialist's model, depends upon (1) the significance of the specialist's work to the auditor's conclusion regarding the relevant assertion; (2) the risk of material misstatement of the relevant assertion; and (3) the knowledge, skill, and ability of the specialist. For example, if the specialist used a proprietary model to develop an independent expectation, the auditor would need to obtain information from the specialist to assess whether the specialist's model was in conformity with the applicable financial reporting framework and to evaluate differences between the independent expectation and the company's recorded estimate.

Another commenter recommended including a requirement to inform auditor-engaged specialists of the need to apply professional skepticism, similar to the requirement for auditor-employed specialists in proposed AS 1201.C6. A different
commenter recommended that the requirements for informing the specialist of the work to be performed should include communicating the auditor's need to exercise professional skepticism to the auditor-engaged specialist, so that the specialist is aware that relevant information should be passed on to the auditor.

The Board considered these comments and determined to adopt the requirement to inform the specialist of the work to be performed substantially as proposed. Due professional care in the performance of audit procedures requires the auditor to exercise professional skepticism, including a questioning mind and a critical assessment of audit evidence. The Board did not propose extending the auditing standard on due professional care to auditor-engaged specialists and, therefore, no change has been made to AS 1210, as amended. While there is no requirement for auditors to make the engaged specialist aware of the auditor's responsibility to exercise professional skepticism, auditors nevertheless may decide to communicate the auditor's responsibility to the auditor-engaged specialist.

Some commenters asserted that the discussion of the auditor's assessment of disclaimers, limitations, and restrictions related to the report of a company's specialist was equally applicable to the report of the auditor-engaged specialist and recommended similar guidance be provided when using the report of an auditor-engaged specialist. Under the final amendments, the auditor's evaluation of the specialist's report or equivalent documentation includes considering the effect of any restrictions, limitations, or disclaimers in the specialist's report or equivalent documentation on both (1) the relevance and reliability of the audit evidence the specialist's work provides and (2) how
the auditor can use the report of the specialist.\textsuperscript{118} For example, a specialist's report that states "the values in this report are not an indication of the fair value of the underlying assets" generally would not provide sufficient appropriate evidence related to fair value measurements. On the other hand, a specialist's report that indicates that the specialist's calculations were based on information supplied by management may still be appropriate for use by the auditor to support the relevant assertion, since the auditor would be required to test the data that was produced by the company and used in the specialist's calculations.

\textbf{Comparison with Standards of Other Standard Setters}

The comparative requirements of the IAASB and the ASB were discussed above.

\textbf{Other Considerations}

The Board proposed to rescind two auditing interpretations.\textsuperscript{119} The Board has taken commenters' views into account and determined not to rescind these interpretations at this time. The Board is incorporating key elements of each interpretation, however, in the final amendments. These matters are discussed below, along with certain requirements in existing AS 1210 that are not specifically addressed in the final amendments.

\textit{Auditing Interpretation AI 11, Using the Work of a Specialist: Auditing Interpretations of AS 1210}

\textsuperscript{118} See note to AS 1210.12, as amended.

\textsuperscript{119} Auditing interpretations provide guidance the auditor should be aware of and consider related to specific areas of the audit. See paragraph .11 of AS 1001, \textit{Responsibilities and Functions of the Independent Auditor}. 

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The Board proposed to rescind AI 11 in the Proposal. AI 11 provides guidance for auditing transactions involving transfers of financial assets, such as in securitizations that are accounted for under Statement of Financial Accounting Standards No. 140.\textsuperscript{120} The interpretation addresses an auditor's use of a legal opinion obtained from a company's legal counsel on matters that may involve the U.S. Bankruptcy Code, rules of the Federal Deposit Insurance Corporation ("FDIC"),\textsuperscript{121} and other federal, state, or foreign law to determine whether "transferred assets have been isolated from the transferor—put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership," which affects the accounting for the transaction under FAS No. 140. AI 11 also reiterates certain requirements in generally accepted accounting principles and PCAOB auditing standards. In addition, the interpretation includes illustrative examples of legal isolation letters based on FAS No. 140 and certain provisions of the FDIC's original rule, both of which have been subsequently amended.

A few commenters supported the proposed rescission. A number of other commenters, however, expressed concern about the proposed rescission of AI 11, stating that it continues to provide useful guidance to auditors regarding the necessary audit evidence to support management's assertion that a transfer of financial assets has met the

\textsuperscript{120} See Financial Accounting Standards Board ("FASB"), Statement of Financial Accounting Standards ("FAS") No. 140, \textit{Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities}. This standard was subsequently amended by FAS No. 166, \textit{Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140}, and codified into FASB Accounting Standards Codification ("ASC"), Topic 860, \textit{Transfers and Servicing}.

\textsuperscript{121} Subsequent to the Board's adoption of AI 11, the FDIC rule regarding the treatment of financial assets transferred by an institution in connection with a securitization or participation was amended in 2010.
isolation criterion of ASC 860-10-40, *Transfers and Servicing*. One commenter asserted that companies would struggle to anchor their accounting conclusions to guidance on the existing auditing standards if AI 11 was rescinded.

After considering comments and the continued use of the interpretation in practice, the Board determined not to rescind AI 11 at this time. The final amendments have been revised to include conforming changes to AI 11 to remove outdated references to existing AS 1210, which has been replaced and retitled.

The amended standards for using the work of a company’s specialist also incorporate certain principles from AI 11. As discussed in AI 11, legal opinions are sometimes necessary evidence to support an auditor’s conclusion about the proper accounting for transfers of financial assets. Accordingly, the final amendments clarify that Appendix A of AS 1105, as adopted, applies in situations when an auditor uses the work of a company’s attorney as audit evidence in other matters relating to legal expertise, such as when a legal interpretation of a contractual provision or a legal opinion regarding isolation of transferred financial assets is necessary to determine appropriate accounting or disclosure under the applicable financial reporting framework. The provision emphasizes the importance of legal opinions as audit evidence in certain contexts and clarifies the requirements the auditor should be applying in such circumstances.

*Auditing Interpretation AI 28, Evidential Matter Relating to Income Tax Accruals: Auditing Interpretations*

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122 See second note to AS 1105.A1, as adopted.
The Board also proposed to rescind AI 28 in the Proposal. AI 28 provides guidance about matters related to auditing the income tax accounts in a company's financial statements. Topics covered by the interpretation include restrictions on access to the company's books and records related to its income tax calculation, documentation of evidence obtained in auditing the income tax accounts, and use of tax opinions from company legal counsel and tax advisors. The interpretation also reiterates certain requirements from PCAOB auditing standards.

Most commenters did not express a view regarding the proposed rescission of AI 28. A few commenters supported the proposed rescission. Two commenters asserted that AI 28 provides useful guidance to auditors regarding tax specialists and tax working papers and should be retained. The Board has considered these comments and determined not to rescind AI 28 at this time.

The Board recognizes that written advice or opinions of a company's tax advisor or tax legal counsel on material tax matters are sometimes necessary evidence to support the auditor's conclusions on income tax accounts. Accordingly, the Board revised the final amendments to acknowledge such situations and to clarify that, if an auditor plans to use an opinion of legal counsel or the advice of a tax advisor on specific tax issues as audit evidence, it is not appropriate for the auditor to rely solely on that opinion or advice with respect to those tax issues.123 Instead, the auditor needs to evaluate the analysis underlying the tax opinion or tax advice to determine whether it provides relevant and

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123 See footnote 1 to AS 1105.A1, as adopted; note to AS 2505.08, as amended.
reliable evidence, taking into account the requirements of the applicable financial
reporting framework.

**Certain Requirements of Existing AS 1210—Discussion of Remaining
Requirements Not Specifically Addressed in the Final Amendments**

**Decision to use a specialist.** Existing AS 1210 states that an auditor may
encounter complex or subjective matters that are potentially material to the financial
statements. It further provides that such matters, examples of which are provided, may
require special skill or knowledge and in the auditor's judgment require using the work of
a specialist to obtain appropriate evidential matter.\(^{124}\) The final amendments do not retain
this language, as this issue is already addressed in AS 2101. Specifically, AS 2101.16
requires the auditor to determine whether specialized skill or knowledge is needed to
perform appropriate risk assessments, plan or perform audit procedures, or evaluate audit
results.

**Reporting requirements.** Existing AS 1210 prohibits auditors from making
reference to the work or findings of a specialist in the auditor's report, unless such
reference will facilitate an understanding of the reason for an explanatory paragraph, a
departure from an unqualified opinion, or a critical audit matter ("CAM"). A CAM is
defined as any matter arising from the audit of the financial statements that was
communicated or required to be communicated to the audit committee and that relates to
accounts or disclosures that were material to the financial statements and involved
especially challenging, subjective, or complex auditor judgment.\(^{125}\) Depending on the

\(^{124}\) See existing AS 1210.06.

\(^{125}\) See AS 3101.11–.17.
circumstances, the description of such CAMs might include a discussion of the work or findings of a specialist.

No commenters objected to omitting the prohibition in existing AS 1210 from the proposed amendments. For the reasons discussed above, the Board did not make changes to the final amendments to incorporate these extant requirements.

**Other Aspects of the Final Amendments**


**Effective Date**

The Board determined that the final amendments take effect, subject to approval by the SEC, for audits of financial statements for fiscal years ending on or after December 15, 2020.

The Board sought comment on the amount of time auditors would need before any amendments would become effective, if adopted by the Board and approved by the SEC. A number of commenters supported an effective date of two years after SEC approval of final amendments, asserting that this would allow firms sufficient time to develop tools, update methodologies, and provide training on the new requirements. A
few commenters also emphasized the importance of having the same effective date for any new standards on using the work of specialists and auditing accounting estimates.

While recognizing other implementation efforts, the effective date determined by the Board is designed to provide auditors with a reasonable period of time to implement the final amendments, without unduly delaying the intended benefits resulting from these improvements to PCAOB standards. The effective date is also aligned with the effective date of the related standards and amendments being adopted in the Estimates Release.

D. Economic Considerations and Application to Audits of Emerging Growth Companies

The Board is mindful of the economic impacts of its standard setting. This economic analysis describes the baseline for evaluating the economic impacts of the final amendments, analyzes the need for the final amendments, and discusses potential economic impacts of the final amendments, including the potential benefits, costs, and unintended consequences. The analysis also discusses alternatives considered.

In the Proposal, the Board had requested input from commenters on their views pertinent to the economic considerations, including the potential benefits and costs, discussed in the Proposal. One commenter stated that it believed the Proposal can be effectively implemented with minimal cost. Several commenters expressed concern, however, that the cost of the Proposal would be relatively greater for smaller audit firms and certain smaller companies. Some commenters also asserted that the Proposal would adversely affect the ability of smaller firms to compete in the audit services market. A number of commenters suggested that the incremental cost of certain aspects of the Proposal would outweigh any increase in audit quality. Finally, some commenters expressed concern that the Proposal could result in a shortage of qualified specialists due
to, for example, a potential increase in the demand for specialists by some audit firms under the proposed requirements.\textsuperscript{126}

The Board has considered all comments received, and has made certain changes to the final amendments to reflect those comments, including changes that mitigate some of the concerns expressed above with respect to the Proposal. The Board has also sought to develop an economic analysis that evaluates the potential benefits and costs of the final amendments, as well as facilitates comparisons to alternative Board actions. There are limited data and research findings available to estimate quantitatively the economic impacts of discrete changes to auditing standards in this area, and furthermore, no additional data was identified by commenters that would allow the Board to generally quantify the expected economic impacts (including expected incremental costs related to the Proposal) on audit firms or companies.\textsuperscript{127} Accordingly, the Board's discussion of the economic impact is qualitative in nature.

**Baseline**

Section C above discusses existing PCAOB requirements for using the work of specialists and existing practice in the application of those requirements. This section addresses from an economic perspective: (1) the prevalence and significance of audits involving specialists; (2) the existing audit requirements that apply to the use of the work

\textsuperscript{126} See below for a discussion of revisions to the proposed requirements in the final amendments to address this concern.

\textsuperscript{127} One commenter provided anecdotal data on certain aspects of the Proposal that was limited to the commenter's experience in one specialized area. The data provided by this commenter, therefore, could not be used to quantify expected economic impacts that would generally apply to the use of the work of specialists.
of specialists; and (3) the quality of audits that involve specialists, based on observations from regulatory oversight and academic literature.

**Prevalence and Significance of Audits Involving Specialists**

**Evidence from PCAOB Inspections Data**

The Proposal observed that the PCAOB staff's analysis of inspections data for audits of issuers suggests that larger audit firms extensively use the work of specialists, in particular auditor-employed specialists, while smaller audit firms generally have a lower percentage of audit engagements in which they use the work of a company's specialist or an auditor's specialist.

The conclusion regarding larger audit firms was based on a PCAOB staff analysis of the 274 issuer audits by U.S. audit firms affiliated with global networks that were selected for inspection in 2015. This analysis found that auditors used the work of at least one auditor-employed specialist in about 85 percent of those audits. For the 85 percent of those audits that involved the use of auditor-employed specialists, an average of four to five individual specialists performed some work on each audit. In addition, on each of

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128 This analysis was performed on engagement-level data obtained through PCAOB inspections. The audits inspected by the PCAOB are most often selected based on risk rather than selected randomly, and these numbers may not represent the use of the work of specialists across a broader population of companies. On average, the engagements selected for inspection are more likely to be complex (and thus more likely to involve the use of the work of a specialist) than the overall population of audit engagements.

129 These firms consist of those U.S. audit firms that are registered with the PCAOB and affiliated with one of the six largest global networks, based on information on network affiliations reported by U.S. audit firms on Form 2 in 2017 and identified on the "Global Networks" overview page, available on the Board's website.
those audits, specialists performed work in one to two fields of expertise on average.\textsuperscript{130} The results indicate that such audits typically had more than one specialist performing work in the same area of expertise.

The Proposal further noted that PCAOB inspections data for issuer audits suggested that, in contrast to larger audit firms, smaller U.S. audit firms generally have fewer audit engagements in which they use the work of a company's specialist or an auditor's specialist. Specifically, the PCAOB staff analyzed data from the 361 audits performed by U.S. audit firms not affiliated with one of the global networks that were selected for inspection by the PCAOB in 2015. Of those 361 issuer audits, the PCAOB staff identified: (1) 36 audits (i.e., about 10% of the analyzed audit engagements) in which the auditor used the work of a company's specialist but did not use the work of an auditor's specialist; (2) 24 audits (i.e., about 7% of the analyzed audit engagements) in which the auditor used the work of an auditor's specialist but did not use the work of a company's specialist; (3) 30 audits (i.e., about 8% of the analyzed audit engagements) in which the auditor used the work of a company's specialist and an auditor's specialist; and (4) 271 audits (i.e., about 75% of the analyzed audit engagements) in which the auditor neither used the work of a company's specialist nor used an auditor's specialist.

A PCAOB staff analysis of the 700 issuer audits by audit firms that were selected for inspection in 2017 is broadly consistent with the conclusions in the Proposal

\textsuperscript{130} The data used in this analysis did not indicate how frequently the auditor used the work of an auditor-engaged specialist.
regarding the prevalence and significance of audits involving specialists.\textsuperscript{131} The results of this analysis are summarized in the table below:

\begin{center}
Figure 5 - Audits performed by U.S. and non-U.S. audit firms that were selected for inspection by the PCAOB in 2017, categorized by use of the work of specialists
\end{center}

\begin{center}
\begin{tabular}{|l|c|c|c|c|}
\hline
 & % (number) of audits by larger audit firms (U.S.) & % (number) of audits by smaller audit firms (U.S.) & % (number) of audits by larger audit firms (non-U.S.) & % (number) of audits by smaller audit firms (non-U.S.) \\
\hline
(1) auditor used the work of a company's specialist but did not use the work of an auditor's specialist & 8\% (26) & 10\% (28) & 8\% (7) & 6\% (1) \\
\hline
(2) auditor used the work of an auditor's specialist but did not use the work of a company's specialist & 20\% (66) & 2\% (6) & 34\% (29) & 0\% (0) \\
\hline
(3) auditor used the work of both a company's specialist and an auditor's specialist & 41\% (136) & 6\% (17) & 29\% (25) & 0\% (0) \\
\hline
(4) auditor neither used the work of a company's specialist nor used an auditor's specialist\textsuperscript{132} & 31\% (102) & 81\% (216) & 29\% (25) & 94\% (16) \\
\hline
\end{tabular}
\end{center}

\textsuperscript{131} The discussion in note 128 that applies to the 2015 analysis—regarding the selection of inspected audit engagements and how such engagements likely compare to the overall population of audit engagements—likewise applies to this 2017 analysis. Unlike the 2015 analysis, the engagement-level data selected for the analysis of PCAOB inspections performed in 2017 included data on issuer audit engagements conducted by non-U.S. as well as U.S. audit firms. In addition, this engagement-level data was based on specific focus areas, such as recurring audit deficiencies and audit areas that may involve significant management or auditor judgment, for issuer audit engagements selected for inspection. For a more detailed discussion of PCAOB inspection focus areas, see PCAOB, \textit{Staff Inspection Brief: Information about 2017 Inspections}, Vol. 2017/3 (Aug. 2017).

\textsuperscript{132} The audit engagements not included in the preceding three categories were included in the fourth category.
<table>
<thead>
<tr>
<th>% (number) of audits by larger audit firms (U.S.)</th>
<th>% (number) of audits by smaller audit firms (U.S.)</th>
<th>% (number) of audits by larger audit firms (non-U.S.)</th>
<th>% (number) of audits by smaller audit firms (non-U.S.)</th>
</tr>
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<tbody>
<tr>
<td>100% (330)</td>
<td>100% (267)</td>
<td>100% (86)</td>
<td>100% (17)</td>
</tr>
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</table>

Source: PCAOB

As indicated by Figure 5, auditors used the work of an auditor's specialist in 61% and 63% of the analyzed audit engagements (the sum of categories (2) and (3) above) by larger audit firms—U.S. and non-U.S. firms, respectively—selected for inspection in 2017. Auditors used the work of a company's specialist without also using the work of an auditor's specialist (category (1) above) in only 8% of the analyzed audit engagements of larger audit firms—both U.S. and non-U.S. firms, respectively—selected for inspection in 2017. These results are also consistent with the anecdotal evidence discussed in section C (i.e., that larger audit firms generally require their engagement teams to evaluate the work of a company's specialist, including the specialist's methods and significant assumptions, and often employ specialists to assist their audit personnel in evaluating that work).

The results for smaller audit firms in Figure 5 are also consistent with the analysis in the Proposal and suggest that the work of an auditor’s specialist or a company's specialist is used in relatively few audits. Specifically, in 81% and 94% of the audits by smaller audit firms—U.S. and non-U.S. firms, respectively—the auditor neither used the work of a company's specialist nor used an auditor's specialist (category (4) above), possibly because those audits did not involve circumstances that warranted the use of specialists by companies or their auditors. Consistent with the analysis of the issuer audits

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133 The total for the values shown in categories (1) through (4) may not add to 100% due to rounding.
selected for inspection in 2015, the results for smaller audit firms in Figure 5 further suggest that, when smaller audit firms use the work of a company's specialist, they often use that work without concurrently using the work of an auditor's specialist. In 62% of the audits by smaller U.S. firms that involved the use of the work of a company's specialist, the audit firm did not concurrently use the work of an auditor's specialist.  

An auditor's specialist also was not concurrently involved in the only audit by a smaller non-U.S. firm that involved the use of the work of a company's specialist (category (1) above).

Evidence from the Academic Literature

Consistent with the results of the PCAOB staff analysis, the academic literature suggests that, when a company uses a company's specialist, some larger audit firms also tend to use the work of an auditor's specialist, at least in the context of audits involving challenging fair value measurements. Furthermore, the academic literature also suggests that the use of valuation specialists is prevalent for at least some audits. One recent study of audits by the four largest firms that involved challenging fair value measurements found that 86% of audit teams used an auditor's specialist, including employed and engaged specialists. In addition, 60% of the companies in this study

134 Specifically, out of the 45 audit engagements of smaller U.S. firms that involved the use of the work of a company's specialists (the sum of categories (1) and (3) in Figure 5), 28 engagements did not concurrently involve the use of the work of an auditor's specialist (category (1) in Figure 5).


136 See Cannon and Bedard, Auditing Challenging Fair Value Measurements:
used a company's specialist, including employed and engaged specialists.\textsuperscript{137} The audits that were included in this study may not be representative of all audit engagements, because they were selected in order to study engagements that involved material, highly challenging fair value measurements. However, the results suggest that the use of an auditor's specialist is at least prevalent among audits performed by the four largest U.S. firms where a company's specialist is used to assist in the development of highly challenging and material fair value measurements, which may also be audit areas with a high risk of material misstatement and thus a need for greater audit attention.\textsuperscript{138}

Furthermore, the academic literature also corroborates the characterizations discussed in section C regarding the current practice of audit firms when using specialists. Academic studies suggest that, at least among the audits that were studied where specialists were used, larger firms were more likely to use the work of auditor-

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\textit{Evidence From the Field} 90. In another study of how auditors use valuation specialists, auditors from seven large U.S. audit firms who were interviewed stated that, on average, 61\% of their engagements in the prior year involved a valuation specialist, including auditor-employed and/or auditor-engaged specialists. \textit{See} Emily E. Griffith, \textit{Auditors, Specialists, and Professional Jurisdiction in Audits of Fair Values} 13 (July 2016) (working paper, available in Social Science Research Network ("SSRN")).
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\textsuperscript{137} See Cannon and Bedard, \textit{Auditing Challenging Fair Value Measurements: Evidence From the Field} 90.
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\textsuperscript{138} Another recent qualitative study conducted through interviewing audit partners, managers, and seniors also observed that auditors in the six large audit firms in Canada consider factors such as the "client's regulatory environment and other general risk factors," "lack of subject matter expertise within the audit team," and "complexity of the engagement" when determining whether to use a specialist. \textit{See} J. Efrim Boritz, Natalia Kochetova-Kozloski, Linda A. Robinson, and Christopher Wong, \textit{Auditors' and Specialists' Views About the Use of Specialists During an Audit} 28, 35 (Mar. 2017) (working paper, available in SSRN).
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employed specialists than auditor-engaged specialists in their engagements, while even among the larger firms there are differences in the extent of their use of the work of auditor-engaged specialists.

A possible explanation for the tendency of larger firms to use the work of auditor-employed specialists (instead of auditor-engaged specialists) is that larger firms, due to the greater number of their audit engagements or their existing non-auditing practices, have sufficient demand for the services of specialists to warrant hiring specialists who work for them full-time. In contrast, smaller firms may not have many audit engagements where the auditor requires the use of an auditor's specialist, so that engaging an auditor's specialist only as needed may be economically more advantageous. In addition, the tendency of smaller firms to look to the work of a company's specialist without using the

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139 See, e.g., Steven M. Glover, Mark H. Taylor, and Yi-Jing Wu, Current Practices and Challenges in Auditing Fair Value Measurements and Complex Estimates: Implications for Auditing Standards and the Academy, 36 (1) Auditing: A Journal of Practice & Theory 63, 75 (2017) ("[R]esults indicate that approximately two-thirds (one-third) of our participants reported that they use in-house (third-party) valuation specialists to support the audit work performed for financial FVMs [i.e., fair value measurements]. Moreover, approximately 87 percent (13 percent) of the audit partners indicated that they use in-house (third-party) valuation specialists to support the audit work for nonfinancial FVMs."); see also Emily E. Griffith, Jacqueline S. Hammersley, and Kathryn Kadous, Audits of Complex Estimates as Verification of Management Numbers: How Institutional Pressures Shape Practice, 32 Contemporary Accounting Research 833, 836 (2015) ("[A]uditors [from the U.S. audit firms affiliated with the six largest global networks] typically enlist audit-firm specialists in auditing estimates because they do not have valuation expertise…").

140 See Griffith, Auditors, Specialists, and Professional Jurisdiction in Audits of Fair Values 58. In this study, all participating auditors from Big 4 audit firms indicated that they used internal valuation specialists (i.e., auditor-employed valuation specialists) and did not use any external valuation specialists (i.e., auditor-engaged valuation specialists). In contrast, only 40% of the auditors from the three other audit firms that participated in the study indicated that they exclusively used internal valuation specialists.
work of an auditor's specialist may reflect the fact that existing AS 1210 enables the auditor to use the work of a company's specialist in a wide range of situations, without imposing obligations on the auditor that might call for the retention of an auditor's specialist.\textsuperscript{141}

\textit{PCAOB Auditing Standards Regarding Use of the Work of Specialists}

As discussed in more detail in section C, under existing standards, the auditor's primary responsibilities with respect to a company's specialist are set forth in existing AS 1210. That standard also imposes the same responsibilities on auditors with respect to an auditor-engaged specialist, even though an auditor-engaged specialist has a fundamentally different role than a company's specialist. While the auditor's specialist performs work to assist the auditor in obtaining and evaluating audit evidence, the company's specialist performs work that is used by the company in preparing its financial statements and that the auditor may use as audit evidence.

The professional relationships between an auditor and a company's specialist, and between an auditor and an auditor's specialist, differ, among other things, in terms of who is employing or engaging the specialist (i.e., the company in the case of a company's specialist and the auditor in the case of an auditor's specialist). Therefore, the level of control and oversight an auditor is able to exercise over the specialist also differs. Given these differences, which expose a company's specialist and an auditor-engaged specialist to different incentives and biases (e.g., pressure to conform to management bias),\textsuperscript{142}

\begin{footnotesize}
\begin{enumerate}
\item[141] Similarly, the final amendments enable the auditor to use the work of a company's specialist in a wide range of situations, without necessarily obligating the auditor to retain an auditor's specialist.
\item[142] For a discussion of pressures facing a company's specialist, see Divya
\end{enumerate}
\end{footnotesize}
requirements would ideally differentiate between the two types of specialists, but existing requirements do not do so.

In contrast, existing PCAOB requirements for using the work of an auditor-employed specialist, who is subject to supervision under AS 1201, differ from the requirements that apply to using the work of an auditor-engaged specialist. Auditor-employed and auditor-engaged specialists may differ in their economic dependency on the auditor and, by extension, could face different incentives to acquiesce to certain auditor decisions, such as a decision by the auditor to downplay or suppress unfavorable information in order to accommodate a conclusion sought by the auditor. While anecdotal evidence from the academic literature related to a company's specialists suggests that employed specialists may face stronger incentives to do so than engaged specialists, it is difficult to generalize as to whether auditor-employed specialists have

Anantharaman, The Role of Specialists in Financial Reporting: Evidence from Pension Accounting, 22 Review of Accounting Studies 1261, 1299-300 (2017) (concluding that "client pressure and opinion shopping" affect the work product of actuaries used by company management, which "suggests potentially greater effects for other specialists not subject to the same levels of oversight (e.g., experts in valuing complex financial instruments and other untraded assets)" and that "economically important clients of their actuaries use more aggressive (obligation-reducing) discount rates [than] less important clients of the same actuary").

143 See, e.g., Griffith, Auditors, Specialists, and Professional Jurisdiction in Audits of Fair Values 32 ("[A]udit teams delete extraneous information in specialists' memos when that information contradicts what the audit team has documented in other audit work papers…") and 33 ("Auditors and specialists described several defensive behaviors by auditors that restrict specialists' access to information...Restricting specialists' access to information can influence how specialists do their work, what work they do, and what conclusions they reach.").

144 See, e.g., J. Richard Dietrich, Mary S. Harris, and Karl A. Muller III, The Reliability of Investment Property Fair Value Estimates, 30 Journal of Accounting and Economics 125, 155 (2001) ("[O]ur investigation reveals that the reliability of fair value estimates varies according to the relation between the appraiser and the [company]

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a greater economic dependency on auditors than auditor-engaged specialists. Any potential bias by auditor-employed and auditor-engaged specialists arising from economic dependency on the auditor may be mitigated by the responsibility imposed directly on the engagement partner under AS 1201 for supervision of the work of engagement team members and compliance with PCAOB standards, including those regarding using the work of specialists. In addition, AS 1220 requires the engagement quality reviewer to "evaluate the significant judgments made by the engagement team and the related conclusions reached in forming the overall conclusion on the engagement and in preparing the engagement report." Such significant judgments may include areas where auditors used the work of an auditor-employed or auditor-engaged specialist.

Furthermore, auditor-employed and auditor-engaged specialists serve similar roles in helping auditors obtain and evaluate audit evidence. Given their similar roles, it seems appropriate that the auditor would follow similar requirements when using both types of specialists, though existing requirements differ for the two types of specialists. A notable difference in the relationship of the auditor with auditor-employed and auditor-engaged specialists, however, relates to the integration of auditor-employed specialists (as compared with auditor-engaged specialists) in an audit firm's or network's quality control

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The extent of economic dependency of an auditor-employed specialist on the auditor will depend, for example, on how much of the specialist's work and the specialist's compensation is related to audits (as opposed to non-audit services), which may vary for different auditor-employed specialists. Similarly, the extent of economic dependency of an auditor-engaged specialist on the auditor will depend on how much of the specialist's overall work or income is connected to the particular audit firm, which may vary for different auditor-engaged specialists.

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systems, which allows the auditor greater visibility into any relationships that might affect the auditor-employed specialist's independence, as well as greater visibility into the auditor-employed specialist's knowledge, skill, and ability. The final requirements with respect to evaluating the objectivity, as well as knowledge, skill, and ability, of an auditor-engaged specialist, therefore, sought to reflect that difference by providing the auditor with specific requirements to assess whether the auditor-engaged specialist has both the necessary objectivity to exercise impartial judgment on all issues encompassed by the specialist's work related to the audit and the level of knowledge, skill, and ability to perform the specialist's work related to the audit.

As discussed in more detail below, given the similar role of an auditor-employed and an auditor-engaged specialist in the audit, the auditor's procedures for reaching an understanding with the specialist and evaluating the work to be performed by the specialist should be similar. However, due to the differences in the auditor's ability to assess the specialist's independence, as well as the specialist's knowledge, skill, and ability, the Board is adopting separate, but parallel, requirements for using the work of an auditor-employed specialist and an auditor-engaged specialist. It is expected that there would be few differences in the procedures undertaken by the auditor when using an auditor's specialist, whether employed or engaged, with such differences limited to the auditor's assessment of the knowledge, skill, ability, and objectivity of an auditor-engaged specialist (where the auditor may not be able to leverage an audit firm's or network's quality control system to perform these assessments).

*Quality of Audits That Involve Specialists*
As discussed in section C, PCAOB oversight of audit engagements in which auditors used the work of a company's or an auditor's specialist and SEC enforcement actions have identified instances of noncompliance with PCAOB standards, e.g., situations where auditors did not appropriately evaluate the work of specialists. For issuer audit engagements, PCAOB staff have more recently observed a decline in the number of instances in which auditors at some audit firms did not perform sufficient procedures related to the work of an auditor's specialist. There are some preliminary indications that some, but not all, firms with observed deficiencies have undertaken remedial actions in response to such findings, which may have contributed, at least in part, to improvements in audit quality related to the auditor's use of an auditor's specialist.

Relatively few empirical academic studies have explicitly examined the relationship between the use of specialists and perceptions of audit quality by investors and auditors. This may be because it is difficult, especially for investors, to assess the effect of using specialists on audit quality independently from the effects of other

\[146\] See, e.g., Brant E. Christensen, Steven M. Glover, Thomas C. Omer, Marjorie K Shelley, Understanding Audit Quality: Insights from Audit Professionals and Investors, 33 Contemporary Accounting Research 1648, 1667 (2016) ("Audit professionals [that were surveyed as part of the study] associate the use of both external experts and internal specialists with higher audit quality."). Relatedly, one recent academic study examined the relationship between the use of forensic accountants (described by the authors as "specialists") and the value of their involvement as perceived by the auditor. While forensic accountants are not specialists within the scope of this standard, the authors of the study argued that the findings "likely translate into understanding other specialist domains." The authors suggested that the involvement of forensic accountants is accompanied by the "incremental discovery of ... material misstatements," and further stated that "our results indicate both auditors and forensic specialists recognize the value and additional comfort that come from forensic specialist involvement on audits." See J. Gregory Jenkins, Eric M. Negangard, and Mitchell J. Oler, Getting Comfortable on Audits: Understanding Firms' Usage of Forensic Specialists, Contemporary Accounting Research, in-press 4 (2017).
relevant factors, such as the quality of the company's financial reporting or internal controls. However, available studies have investigated the relationship between the quality of financial statement estimates, which often are provided with the assistance of a company's specialist, and the usefulness of such estimates to investors. These studies find that less reliable estimates tend to be less useful to investors. Other studies suggest that some estimates are also more likely to be discounted by investors. Because investors' perceptions of the credibility of financial statements are influenced by their perceptions of audit quality, the auditor's appropriate use of the work of specialists should increase the credibility of the accounting estimates included in the financial statements.

Need for the Rulemaking

147 While not directly assessing the relationship between the use of specialists and perceptions of audit quality, academic literature has investigated factors that influence an auditor’s approach to auditing accounting estimates, including the decision whether to use the work of specialists. See, e.g., Jennifer R. Joe, Scott D. Vandervelde, Yi-Jing Wu, *Use of High Quantification Evidence in Fair Value Audits: Do Auditors Stay in their Comfort Zone?*, 92 (5) The Accounting Review 89 (2017); Emily E. Griffith, *When Do Auditors Use Specialists’ Work to Improve Problem Representations of and Judgments about Complex Estimates?*, 93 (4) The Accounting Review 177 (2018).


From an economic perspective, the primary cause for market failure\textsuperscript{150} that motivates the need for the final amendments is the moral hazard\textsuperscript{151} affecting the auditor's decisions on how to implement audit procedures related to the use of the work of a specialist, which increases the risk of lower audit quality from the investor's perspective.

As described in the Proposal, the moral hazard problem related to the use of the work of a specialist generally manifests in the auditor not performing appropriate procedures, even though such procedures would improve audit quality by increasing the auditor's attention, because the auditor may not perceive sufficient economic benefit (compared to the corresponding costs\textsuperscript{152} and efforts) from such actions. Specifically, when auditors use the work of a company's specialist, moral hazard may take the form of the auditor failing to evaluate data, significant assumptions, and methods used by the


\textsuperscript{151} The moral hazard problem is also referred to as a hidden action, or agency problem, in economics literature. The term "moral hazard" refers to a situation in which an agent could take actions (such as not working hard enough) that are difficult to monitor by the principal and would benefit the agent at the expense of the principal. To mitigate moral hazard problems, the agent's actions need to be better aligned with the interests of the principal. Monitoring is one mechanism to mitigate these problems. See, e.g., Bengt Holmström, \textit{Moral Hazard and Observability}, 10 The bell Journal of Economics 74 (1979).

\textsuperscript{152} For a discussion of the effect of cost pressures on audit quality, compare James L. Bierstaker and Arnold Wright, \textit{The Effects of Fee Pressure and Partner Pressure on Audit Planning Decisions}, 18 Advances in Accounting 25, 40 (2001) (finding, as the result of their experiment, that "auditors significantly reduced budgeted hours … and planned tests … in response to fee pressure") with Bernard Pierce and Breda Sweeney, \textit{Cost–Quality Conflict in Audit Firms: An Empirical Investigation}, 13 European Accounting Review 415 (2004) (finding, in relation to the Irish market, that "dysfunctional behaviours" are related to time pressure and performance evaluation).
specialist to an extent that would be commensurate with the risk of material misstatement inherent in the specialist's work. Moral hazard in the context of auditors using the work of a company's specialist might also take the form of the auditor failing to appropriately assess relationships between the company's specialist and the company. In addition, when auditors use the work of an auditor's specialist, moral hazard may, for example, take the form of not performing procedures, or performing insufficient procedures, to communicate and reach an understanding with the specialist regarding the specialist's responsibilities and the objectives of the specialist's work, or insufficiently evaluating that work.

In such contexts, moral hazard is made possible by the information asymmetry that exists due to the lack of transparency about the nature of the auditor's work (i.e., between the auditor on the one hand, and investors on the other hand). Investors typically do not know whether an auditor used the work of a specialist and, if so, how the work of the specialist was used. Because of this information asymmetry, the auditor may face little to no scrutiny from investors or others (e.g., audit committees) regarding his or her

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153 See Anantharaman, The Role of Specialists in Financial Reporting: Evidence from Pension Accounting, at 1265 (describing empirical evidence that suggests that auditors "have difficulty in screening out relationships" that might impair the "objectivity" of company specialists).

154 Alternatively, it is conceivable that, in some situations, moral hazard may take the form of the auditor either influencing the findings or conclusions that specialists reach or modifying the specialist's work after the fact to support the conclusions sought by the auditor. See supra note 143.

155 Economists often describe "information asymmetry" as an imbalance, where one party has more or better information than another party. For a discussion of the concept of information asymmetry, see, e.g., George A. Akerlof, The Market for "Lemons": Quality Uncertainty and the Market Mechanism, 84 The Quarterly Journal of Economics 488 (1970).
audit procedures when using the work of specialists, and may perceive limited
economic benefits (e.g., gains in revenue, gains in professional reputation, or a reduction
in potential liability) in incurring costs to perform additional audit work. Hence, the
moral hazard problem between the auditor and investors may have a detrimental impact
on audit quality.  

Because market forces (e.g., pressure and demands from investors) may not be
effective in making the auditor more responsive to investor interests with respect to the
use of the work of specialists, from an economic perspective, the situation absent

156 This is true for other aspects of the audit engagement as well and hence the audit can be thought of providing investors with a credence service. Credence services are difficult for users of the service (such as investors in the context of company audit services) to value because their benefits are difficult to observe and measure. See Monika Causholli and W. Robert Knechel, An Examination of the Credence Attributes of an Audit, 26 Accounting Horizons 631 (2012). See also Alice Belcher, Audit Quality and the Market for Audits: An Analysis of Recent UK Regulatory Policies, 18 Bond Law Review 1, 5 (2006) (An "audit is a credence service in that its quality may never be discovered by the company, the shareholders or other users of the financial statements. It may only come into question if a 'clean' audit report is followed by the collapse of the company.").

157 Additionally, such situations may occur because the auditor made an error in judgment assessing the audit risk involved when using the work of an auditor's specialist or a company's specialist. In situations in which "objectives and the actions needed to achieve them are complex and multifaceted, it is inevitable that different people...will...interpret...them in different ways..." See John Hendry, The Principal's Other Problems: Honest Incompetence and the Specification of Objectives, 27 Academy of Management Review 98, 107–108 (2002). When people are choosing their actions in such situations, Hendry argues that the predicted actions (and hence resulting problems) are more or less the same, whether one assumes that they are unselfish yet "prone to mak[ing] mistakes," or instead are self-interested and opportunistic yet unlikely to make mistakes. Id. at 100.

158 The degree of responsiveness of the auditor to investor interests, such as increasing audit effort in some circumstances when using the work of specialists, may also be related to, among other things, the auditor's ability to pass on cost increases to companies (and, ultimately, to investors) in the form of higher audit fees. See infra note 175 for a further discussion of cost pass-through.
standards would be characterized as a form of market failure. While existing standards regarding the use of the work of a company's specialist and an auditor-engaged specialist are intended to address and mitigate potential auditor moral hazard, they could be aligned more closely with the risk assessment standards, which could enhance audit quality. In addition, while auditor-employed specialists are supervised under a risk-based approach, specifying requirements for applying that approach when using an auditor-engaged specialist could promote an improved, more uniform approach to supervision. Additionally, if the work of an auditor's specialist is not properly overseen or evaluated (or the work of a company's specialist is not properly evaluated), there may be a heightened risk that the auditor's work will not be sufficient to detect a material misstatement in significant accounts and disclosures.

Furthermore, the auditor does not engage or employ a company's specialist and does not supervise the work of a company's specialist. This makes the auditor's use of the work of a company's specialist different from the auditor's use of an auditor's specialist in several important ways. First, because of the different relationships the auditor has with a company's specialist and with an auditor's specialist, the auditor's assessment of the qualifications and relationships of a company's specialist requires greater effort by the auditor compared to the auditor's equivalent procedures with respect to an auditor's specialist. Second, the auditor's consideration of data, significant assumptions, and methods used by the company's specialist may also be more challenging (for example, due to the specialist's use of proprietary data), compared to equivalent procedures performed by the auditor when using a specialist with whom the auditor has an employment or contractual relationship. Third, an auditor is generally more likely to be
familiar with an auditor's specialist than with a company's specialist (e.g., with the professional qualifications, reputation, and work), which reduces the costs associated with the ongoing monitoring of the specialist's work. Given these differences, the standards would ideally differentiate between the two types of specialists, but existing AS 1210 currently does not do so. Accordingly, the potential for moral hazard relating to the auditor's use of the work of a company's specialist is a particular focus of the requirements in the final amendments to AS 1105.

The need to enhance existing standards is further heightened by the fact that it may be particularly challenging for the auditor to evaluate the work of either an auditor's specialist or a company's specialist or to supervise an auditor's specialist. The work of a company's specialist or an auditor's specialist often involves professional judgment, the nature of which the auditor may not fully appreciate when evaluating the work of the specialist. In particular, the specialist's work is highly technical in nature and often is not entirely transparent to the auditor, who may not have complete access to the specialist's work or the same level of knowledge and skill in the specialist's field. Thus, due to the potential that an auditor would incur relatively higher cost to supervise an auditor's

For example, as further discussed in section C, some commenters on the Proposal expressed concern that the auditor may have limited access to proprietary information used by a company's specialist or an auditor-engaged specialist (as compared with information used by an auditor-employed specialist). The final amendments do not require the auditor to obtain such proprietary information, but instead to obtain sufficient information to assess whether the model is in conformity with the applicable financial reporting framework.

See, e.g., Griffith, Auditors, Specialists, and Professional Jurisdiction in Audits of Fair Values 23 ("[Results] show[ ] that many auditors review specialists' work for general understanding and sufficiency of the work performed, rather than reviewing in detail as they would in other areas of the audit. They approach the review this way because they cannot fully understand specialists' work.").
specialist or to evaluate the work of a company's or an auditor's specialist, the auditor may have incentives to forego procedures related to the use of the work of specialists that could be beneficial to investors.

The potential negative impact on audit quality of the auditor's incentives to forgo procedures is compounded by the possibility that an auditor's specialist may perceive little benefit (compared to the corresponding costs and efforts) in fully carrying out their responsibilities, including the objectives of the work to be performed. Alternatively, the specialist may in some instances believe that he or she faces few negative consequences (such as an increase in potential liability) when performing low quality work or, as one commenter on the Proposal asserted, an auditor's specialist may not set forth conclusions anticipated to be rejected by the auditor. However, any such concerns are at least partially alleviated to the extent specialists are subject to codes of conduct, standards, and disciplinary processes of their own profession or could perceive a risk of reputational damage.

The Proposal stated that enhanced performance standards regarding the use of the work of specialists might improve audit quality and benefit investors. One commenter

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\[161\] To the extent that an auditor's specialist has a stronger relationship with the auditor (e.g., repeated business interactions between the specialist and the auditor), the potential for moral hazard arising in the context of the auditor using such an auditor's specialist could be higher. However, a stronger relationship between the auditor and the auditor's specialist may also result in the specialist's work being more commensurate with the risk of material misstatement associated with the financial statement assertion and, therefore, improve audit quality.

\[162\] See, e.g., Letter from American Academy of Actuaries (Aug. 29, 2017), at 1–2, available on the Board's website in Docket 044 (stating that the Academy's members "are subject to a code of professional conduct, standards of qualification and practice, and a disciplinary process" and that "our profession has a specific standard that defines appropriate practice for actuaries during the course of an audit").
asserted that the Proposal had not articulated a pervasive problem that would be solved by a change in auditing standards. This commenter further stated that it was not persuaded that a change in the audit framework for the auditor's use of specialists was necessary, based on its view that a significant amount of audit work is currently being performed. The Board believes, however, that the changes in the final amendments described in section C are needed (and preferable to other policy-making approaches)\(^{163}\) because market forces alone cannot mitigate the moral hazard problem described above.

Strengthening the requirements for evaluating the work of a company's specialist, as well as applying a risk-based supervisory approach when using the work of both auditor-employed and auditor-engaged specialists, will prompt auditors to plan and perform audit procedures commensurate with the risk of material misstatement inherent in the specialist's work, and thereby mitigate the moral hazard problem. The final amendments direct more audit attention and effort, when using the work of specialists, to areas where the specialist's work is more significant to the auditor's conclusion on a financial statement assertion and the risk of material misstatement is higher.

Specifically, as discussed in section C, the final amendments mitigate the moral hazard problem by linking the auditor's responsibilities for determining the necessary evidence when evaluating the work of the company's specialist, including the data, significant assumptions, and methods used by the specialist, to four factors: the risk of material misstatement of the relevant assertion; the significance of the specialist's work to the auditor's conclusion regarding that assertion; the level of knowledge, skill, and ability

\(^{163}\) See below for a discussion of why the Board believes that standard setting is preferable to other policy-making approaches.
of the specialist; and the ability of the company to significantly affect the specialist's judgments about the work performed, conclusions, or findings.

Further, the final amendments mitigate the moral hazard problem in the context of the use of the work of an auditor’s specialists by clarifying the auditor's supervisory responsibilities over auditor-employed specialists and establishing parallel requirements when auditors use the work of auditor-engaged specialists, as discussed in section C. In addition, the necessary extent of supervision under the final amendments depends on factors similar to those that govern the necessary auditor effort in evaluating the work of a company's specialist.

Economic Impacts

The magnitude of the benefits and costs of the final amendments will be affected by the nature of and risks involved in the work performed by specialists, because more complex work and work in areas of greater risk will likely require greater audit effort, holding all else constant. In addition, benefits and costs are likely to be affected by the degree to which auditors have already adopted audit practices and methodologies that are similar to those that the final amendments will require.\footnote{164}

The remainder of this subsection discusses the potential benefits, costs, and unintended consequences that may result from the final amendments the Board is adopting.

\textit{Benefits}

\footnote{164 Additionally, the new standard and related amendments in the Estimates Release, \textit{supra} note 20, may affect the future prevalence and significance of the use of the work of specialists and, therefore, have an impact on the benefits and costs of the final amendments discussed in this section.}
The requirements in the final amendments are expected to benefit investors and auditors by directing auditors to devote more attention to the work of specialists and enhancing the coordination between auditors and their specialists. This should mitigate the problem of auditor moral hazard discussed in the preceding section and contribute to improved audit quality. The final amendments are intended to accomplish this, and increase the likelihood that auditors will detect material misstatements, through requirements that take into account current auditing practices by some larger audit firms and more strongly align auditors' interests with the interests of investors when auditors use the work of specialists. At the same time, by fostering improved audit quality, the final amendments should increase investors' perception of the credibility of a company's financial statements, and help address uncertainty about audit quality and the potential risks associated with the use of the work of company specialists, auditor-employed specialists, and auditor-engaged specialists.

The Board believes that investors will benefit from the final amendments because the application of the requirements should result in more consistently rigorous practices among auditors when using the work of a company's specialist in their audits, as well as a more consistent approach to the supervision of auditor-employed and auditor-engaged specialists. The current divergence in practices related to the auditor's use of the work of specialists, combined with a lack of information about such divergence, could mean that investors are unable to distinguish the quality of each audit separately, which in turn could lead investors to discount the quality of all audits. Conversely, greater consistency in such practices—such as would be promoted by the final amendments—could mitigate those concerns by both enhancing the quality of less rigorous audits and correcting the
inappropriate discounting of more rigorous audits. From an investor's perspective, and as one commenter concurred, the increase in audit quality that should result from the final amendments should contribute to investor protection. Specifically, an increase in audit quality may increase the quality of the information provided in a company's financial statements and decrease the cost of capital for that company, especially if less information is available about the company because it has a shorter financial reporting history.

From a broader capital markets perspective, an increase in the information quality of a company's financial statements because of improved audit quality can increase the efficiency of capital allocation decisions. In other words, an increase in the information quality of companies' financial statements can reduce the non-diversifiable risk to

See, e.g., Richard A. Lambert, Christian Leuz, and Robert E. Verrecchia, Accounting Information, Disclosure, and the Cost of Capital, 45 Journal of Accounting Research 385, 386-7 (2007) ("[A]ccounting information influences a [company's] cost of capital ... where higher quality accounting information ... affects the market participants' assessments of the distribution of future cash flows"); see also Randolph P. Beatty, Auditor Reputation and the Pricing of Initial Public Offerings, 64 The Accounting Review 693, 696 (1989) ("Since auditing firms that have invested more in reputation capital have greater incentives to reduce application errors, the information disclosed in the accounting reports audited by these firms will be more precise, ceteris paribus. This reduction in measurement error will allow uninformed investors to estimate more precisely the distribution of firm value.").

See, e.g., Jeffrey A. Pittman and Steve Fortin, Auditor Choice and the Cost of Debt Capital for Newly Public Firms, 37 Journal of Accounting and Economics 113, 114 (2004) ("[E]ngaging [an audit firm with] a brand name reputation for supplying higher-quality audit that enhances the credibility of financial statements, enables young [companies] to reduce their borrowing costs...[O]ur research suggests that the economic value of auditor reputation declines with age as [companies] shift toward exploiting their own reputations to reduce information asymmetry.").
investors and generally should result in investment decisions by investors that more accurately reflect the financial position and operating results of each company.  

In addition to the general benefits to investors and the capital markets described above, the final amendments should result in specific benefits to auditors. In particular, the final amendments should lead to improvements in the ability of auditors to supervise auditor-employed and auditor-engaged specialists and evaluate their work, to the extent that auditors devote more attention to the work of auditor-employed and auditor-engaged specialists and enhance the coordination with those specialists. The final amendments with regard to the use of the work of a company's specialist should also lead to improvements in the auditor's understanding of the data, significant assumptions, and methods used by the company's specialist. As auditors are better able to identify and detect potential risks of material misstatement, this may also spur companies and their specialists over time to improve the quality of financial reporting and their work.

The final amendments may also contribute to the aggregate benefits of the auditing standards (i.e., by enhancing auditors' understanding of, and compliance with, other PCAOB auditing standards), in addition to the other improvements in audit quality described above. For example, the final amendments to evaluate the work of a company's specialist should also lead to improvements in the auditor's understanding of the data, significant assumptions, and methods used by the company's specialist. As auditors are better able to identify and detect potential risks of material misstatement, this may also spur companies and their specialists over time to improve the quality of financial reporting and their work.

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See, e.g., Lambert et al., Accounting Information, Disclosure, and the Cost of Capital 388 (finding that information quality directly influences a company's cost of capital and that improvements in information quality by individual companies unambiguously affect their non-diversifiable risks); Ahsan Habib, Information Risk and the Cost of Capital: Review of the Empirical Literature, 25 Journal of Accounting Literature 127, 128 (2006) ("A commitment to increased level [and quality] of disclosure reduces the possibility of information asymmetries and hence should lead to a lower cost of capital effect. … In addition, high quality auditing … could provide credible information in the market regarding the future prospect of the [company] and hence could reduce the cost of capital in general, and cost of equity capital in particular." (footnote omitted)).
specialist should result in some auditors developing a better understanding of the company's accounting estimates in significant financial statement accounts and disclosures. In turn, this may also result in improved communications with audit committees.\textsuperscript{168}

The magnitude of the benefits discussed in this section resulting from improved audit quality will likely vary to the extent that current practices are aligned with the final amendments. Based on observations from the Board's oversight activities, most firms would need to enhance their methodologies, but to varying degrees. In general, both the greatest changes and the greatest benefits are likely to occur with auditors that need to enhance their methodologies the most.

\textit{Costs}

The Board recognizes that the benefits of the final amendments will come at additional costs to auditors and the companies they audit. As with any changes to existing requirements, it is anticipated that there will be one-time costs for auditors associated with updating audit methodologies and tools, preparing new training materials, and conducting training.\textsuperscript{169} The final amendments could also give rise to recurring costs in the form of additional time and effort spent on any individual audit engagement by specialists and engagement team members.

\textsuperscript{168} See paragraphs .12c and .13c of AS 1301, \textit{Communications with Audit Committees}, for the auditor's communication requirements related to the company's critical accounting estimates.

\textsuperscript{169} The PCAOB has observed that larger firms are likely to update their methodologies using internal resources, whereas smaller firms are more likely to purchase updated methodologies from external vendors.
The most significant impact of the final amendments on costs for auditors is expected to result from the requirements to evaluate the work of a company's specialist. This area of potential impact was also noted by some commenters on the proposed requirements for testing and evaluating the work of a company's specialist.

Compared with the existing requirements, the auditor will be required under the final amendments to evaluate the significant assumptions used by the company's specialist whenever the specialist's work is used, rather than only in certain circumstances, as well as the methods used by the specialist. In practice, these requirements may result in auditors performing more work or using an auditor’s specialist to assist them in evaluating the work of a company's specialist. This may lead to significant changes in practice for some firms, particularly smaller firms that currently do not employ specialists and follow methodologies solely based on existing AS 1210, even though the final amendments do not require the auditor to use the work of an auditor's specialist.

Compared to the Proposal, however, the final amendments clarify the auditor's responsibility when evaluating the work of the company's specialist and, therefore, should further limit any incremental cost to circumstances where increases in audit quality can be reasonably expected. For example, as detailed in section C, the final

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\(^{170}\) See existing AS 1210.12.

\(^{171}\) In circumstances when an auditor is auditing fair value measurements and disclosures in accordance with AS 2502, footnote 2 of that standard provides that management's assumptions include assumptions developed by a specialist engaged or employed by management. Therefore, the auditor is currently required to evaluate the reasonableness of significant assumptions developed by the company's specialist when auditing a fair value measurements and disclosures.
amendments reflect changes to the Proposal relating to the auditor's evaluation of the
data, significant assumptions, and methods used by the company's specialist. These
revisions clarify that the focus of the auditor's evaluation does not require reperforming
the specialist's work. Instead, the auditor's responsibility is to evaluate whether the
specialist's work provides sufficient appropriate evidence to support a conclusion
regarding whether the corresponding accounts or disclosures in the financial statements
are in conformity with the applicable financial reporting framework.

In addition, some of the expected cost increases for auditors due to the final
amendments are likely to be offset by the implementation of more risk-based audit
approaches in practice (e.g., more targeted procedures when using the work of
specialists). More risk-based audit approaches reduce the risk to the auditor of failing to
detect material misstatement and thus could lead to a reduction in costs resulting from
potential liability or reputational loss faced by auditors.

The final amendments' impact on costs for auditors could also vary based on the
size and complexity of an audit engagement. Holding all else constant, anticipated costs
generally would be higher for larger, more complex audits than for smaller, less complex
audits. As discussed above, a smaller portion of audits performed by smaller audit
firms tend to involve use of the work of specialists, compared with audits performed by
larger audit firms. Accordingly, it is reasonable to infer that relatively fewer audits of
smaller firms will be impacted by the final amendments than audits of larger firms.

\[172\] \text{See Letter from American Academy of Actuaries (July 31, 2015), at 18,}
\text{available on the Board's website in Docket 044 (stating that "smaller audit firms also tend
to have clients that require fewer special needs" and thus implying that audit
engagements of smaller audit firms tend to be less complex than audit engagements of
larger audit firms).}
The impact of the final amendments would also likely vary, however, depending on the extent to which elements of the final amendments have already been incorporated in an audit firm’s methodologies or applied in practice by individual engagement teams. For auditors that have already implemented elements of the final amendments, the costs of implementing the final amendments will be lower than for firms that currently perform more limited audit procedures. For example, some firms employ procedures to reach and document their understanding with an auditor’s specialist about, among other things, the responsibilities of the auditor’s specialist and the nature of the work to be performed. Firms that do not already employ such procedures may incur additional costs under the final amendments.

Similarly, the incremental impact of the final amendments on costs incurred by auditors would likely vary depending on, among other things, how many of an audit firm’s engagements involve the use of the work of specialists. Among audit firms that use the work of specialists on their engagements, the anticipated costs would likely be higher for those firms that use the work of specialists more frequently or extensively than for firms that do so less frequently or extensively. Larger audit firms generally perform a larger number of audit engagements, however, and the incremental impact of the final amendments on their costs per engagement should be lower than for smaller firms that generally perform a smaller number of audit engagements. This would be the case regardless of whether the audit engagements of the larger and smaller firms involve the use of the work of specialists, since larger firms, due to their existing economies of
scale\textsuperscript{173} and scope\textsuperscript{174} would tend to be able to distribute the overall cost impact of the final amendments over a larger number of audit engagements.

Some commenters argued that the Proposal could lead, in some instances, to significant (and potentially pervasive) increases in auditing costs, due to increased audit effort that would not necessarily be accompanied by corresponding increases in audit quality. In contrast, one commenter asserted that the requirements could be implemented effectively with minimal costs. In adopting the final amendments, the Board modified certain of the proposed amendments with the intent that the final amendments be risk-based and scalable, and that any cost increases be accompanied by commensurate improvements in audit quality. For example, as discussed earlier in this subsection, the final amendments reflect changes to the Proposal relating to the auditor's evaluation of the data, significant assumptions, and methods used by the company's specialist. These changes clarify that the focus of the auditor's evaluation does not require reperforming

\begin{quote}
\textsuperscript{173} See Economies of Scale and Scope, The Economist, Oct. 20, 2008 (available at https://www.economist.com/news/2008/10/20/economies-of-scale-and-scope) ("Economies of scale are factors that cause the average cost of producing something to fall as the volume of its output [i.e., number of audit engagements] increases."). In this context, the average cost would likely fall with the number of audit engagements, because certain costs, such as the cost of employing specialists, are not directly related to the number of audit engagements that an auditor assumes. See also Simon Yu Kit Fung, Ferdinand A. Gul, and Jagan Krishnan, \textit{City-Level Auditor Industry Specialization, Economies of Scale, and Audit Pricing} 87 The Accounting Review 1281, 1287 (2012) ("For an audit firm, the scale economies can arise from substantial investment in general audit technology (e.g., audit software development or hardware acquisition) and human capital development (e.g., staff training), which are likely to be shared among all of their clients. Once these investments are in place, additional clients can be serviced at a lower marginal cost than the cost of servicing the first few clients.").
\end{quote}

\begin{quote}
\textsuperscript{174} See Economies of Scale and Scope, The Economist ("[E]conomies of scope [are] factors that make it cheaper to produce a range of products together than to produce each one of them on its own. Such economies can come from businesses sharing centralised functions…").
\end{quote}
the specialist's work and thus should limit incremental costs to situations where more auditor involvement is necessary to address the identified risk of material misstatement.

The final amendments might result in additional costs for some companies, compared to costs incurred under current requirements, to the extent that the final amendments lead auditors to raise their audit fees. Such additional costs could vary for the same reasons as described above relating to the final amendments' potential impact on costs incurred by auditors. The final amendments could also give rise to new recurring costs for management, to the extent that the final amendments result in the need for companies to devote more time and resources to respond to auditor inquiries and requests. Some commenters on the Proposal expressed concern about the potential cost to companies, including smaller companies. For example, one commenter suggested that companies might need to provide more support for their discount rate assumptions under the proposed amendments. On the other hand, another commenter suggested that, in the context of the size of the U.S. fixed income market, consistent use of methodologies

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175 It is not clear to what extent the final amendments will result in higher audit fees. The Board is aware of public reports that have analyzed historical and aggregate data on audit fees and suggest that audit fees generally have remained stable in recent years, notwithstanding the fact that the Board and other auditing standard setters have issued new standards and amended other standards during that period. See, e.g., Audit Analytics, Audit Fees and Non-Audit Fees: A Fifteen Year Trend (Dec. 2017). For a general discussion of cost pass-through, see, e.g., James Bierstaker, Rich Houston, Arnold Wright, The Impact of Competition on Audit Planning, Review, and Performance, 25 Journal of Accounting Literature 1, 12 (2006) (summarizing research on the market for audit services and finding "there is evidence of lower fee premiums when clients switch auditors, suggesting that auditors are less able to pass on the increased costs associated with new audits in a more competitive environment"); and RBB Economics, Brief 48: The Price Effect of Cost Changes: Passing Through and Here to Stay 1, 3 (Dec. 2014).
compliant with fair value accounting requirements by companies would be a small cost to bear.

For many companies (and, indirectly, investors), however, the final amendments should not result in significant additional costs or significantly increased audit fees, particularly recurring costs, as their auditors, especially if they are larger audit firms, may have already incorporated many or all elements of the final amendments into their audit methodologies, and individual engagement teams may already be applying many or all of the final amendments in practice. In addition, the changes from the Proposal reflected in the final amendments, which clarify the auditor's responsibility when evaluating the work of the company's specialist, should mitigate some of the potential additional costs suggested by commenters.

**Unintended Consequences**

In addition to the benefits and costs discussed above, the final amendments could have unintended economic impacts, the possibility of which the Board has taken into account in adopting the final amendments. The discussion below describes the potential unintended consequences that were identified in the Proposal or by commenters, as well as the Board's consideration of such consequences in adopting the final amendments. The discussion also addresses, where applicable, factors that mitigate the potential negative consequences, including revisions to the proposed amendments reflected in the final amendments and the existence of other countervailing factors.

**Potential Adverse Impact on the Ability of Smaller Firms to Provide Audit Services**

In instances where the final amendments would increase the need of some audit firms to use the work of an auditor's specialist (rather than only use the work of a
company's specialist under existing AS 1210), the final amendments might result in some smaller firms accepting fewer audit engagements that would require the use of an auditor's specialist. Relatedly, in such instances, some smaller firms might be inhibited from expanding their audit services for similar reasons. The Board had acknowledged the possibility of such unintended consequences in the Proposal, and some commenters also expressed the view that the proposed amendments might adversely impact the ability of smaller firms to provide audit services in certain situations.

In particular, to the extent that auditors at smaller audit firms have less experience evaluating the work of a company's specialist than auditors at larger firms, some auditors may have an increased need to use the work of an auditor's specialist for certain engagements. Potentially, such firms would be unable to take advantage of the economies of scale and scope available to larger firms (for example, if they did not employ their own specialists and had to identify and engage qualified specialists), and find it economically less attractive to accept such engagements. In addition, some commenters on the Proposal suggested more broadly that the ability of smaller firms to compete in the audit services market would be adversely affected. The Board acknowledges that the final amendments could have a more significant impact on smaller firms than on larger firms. However, the Board believes that two factors will lessen any such adverse impact of the final amendments on smaller firms.

First, as described earlier in this section, the evidence from PCAOB inspections data indicates that smaller audit firms generally have comparatively few audit engagements in which they use the work of a company's specialist or an auditor's specialist. For example, the results for smaller audit firms in Figure 5 above indicate that
the auditors did not use the work of either a company's specialist or an auditor's specialist in 81% and 94% of the audits of smaller audit firms—U.S. and non-U.S. firms, respectively—inspected in 2017, and that the auditors used the work of a company's specialist without also using the work of an auditor's specialist in only 10% and 6% of the audits of smaller audit firms—U.S. and non-U.S. firms, respectively—inspected in 2017. These results suggest that the number of engagements where smaller firms might be faced with using an auditor's specialist for the first time to evaluate the work of a company's specialist under the final amendments is a relatively small proportion of audits subject to the Board's standards.

Second, there is some evidence that smaller and larger audit firms do not directly compete with one another in some segments of the audit market. To the extent smaller audit firms compete in different segments of the audit market than larger audit firms, the competitive impact of the final amendments on smaller firms would be lessened.

Taking into consideration the factors described above, the final amendments further mitigate the potential adverse impact on the ability of smaller firms to provide audit services involving, or compete for audit engagements that require, the use of the

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176 The fact that the auditor did not use the work of an auditor's specialist does not imply that the auditor should have used the work of an auditor's specialist.

177 Furthermore, given that the engagements selected for inspection are on average more likely to be complex (and thus more likely to involve the use of the work of a specialist) than the overall population of audit engagements of smaller audit firms, the percentage results shown above for audits involving the use of the work of specialists are likely greater than the actual percentage of the overall population of audit engagements of smaller audit firms.

work of specialists. For example, the clarifications in the final amendments for evaluating
the work of a company's specialist, such as limiting the use of the term "test" to
procedures applied to company-produced information used by the specialist, should
alleviate concerns expressed by certain commenters on the Proposal that auditors would
be required to reperform the work of a company's specialist. In addition, under the final
amendments, auditors are allowed to assess the objectivity of an auditor-engaged
specialist along a spectrum, rather than make a binary determination whether they can use
the work of an auditor-engaged specialist.\textsuperscript{179}

\textbf{Potential Diversion of Auditor Attention from Other Tasks that Warrant Attention}

In some audit engagements involving specialists, the final amendments might lead
auditors to devote more of their attention and resources to the work of a company's
specialists (including the related training of audit personnel) and to enhancing the
coordination with an auditor's specialists, and less time and resources to other tasks that
warrant greater attention.

The potential impact on overall audit quality might vary as the re-orientation of
attention would occur in different ways for each audit engagement. Any potential adverse
impact on overall audit quality is mitigated, however, by the risk-based approach in the
final amendments to using the work of specialists. To the extent that the re-orientation of
the auditor's attention leads to more effort in areas with the greatest risk of material
misstatement to the financial statements, overall audit quality would be expected to
\textsuperscript{179} Similarly, the final amendments recognize that a company's ability to
significantly affect the judgments of a company's specialist may vary and provide for the
auditor to evaluate along a spectrum the company's ability to significantly affect those
judgments.
increase. Furthermore, if auditors devote more attention to the work of specialists and enhancing the coordination with their specialists, the final amendments will result in some auditors acquiring greater expertise, which could positively affect the quality of audit work performed by such auditors. Such auditor specialization could lead some audit firms to seek fewer audit engagements involving specialists, while other firms might seek more such engagements. In such a market, the competitive effects of increased specialization would likely be highly dependent on the circumstances.

Potential for Unnecessary Effort by the Auditor or the Auditor’s Specialist

Under the final amendments, the potential exists that auditors might interpret the final requirements to suggest that they should use the work of an auditor’s specialist in situations where the auditor had already obtained sufficient appropriate evidence with respect to a relevant assertion of a significant account or disclosure. The Proposal also identified this potential consequence, and some commenters expressed concern that auditors might feel compelled to do more work than was necessary or optimal under the proposed requirements. This unintended consequence might also arise under the final amendments if an auditor had already evaluated the work of a company's specialist, but decided to employ or engage its own specialist to perform additional procedures. For example, the auditor might ask an auditor's specialist to develop or assist in developing an independent expectation of an estimate in order to further demonstrate his or her diligence or err on the side of caution. In some instances, it is possible that the auditor might do so even though the auditor believes the costs of using the work of an auditor's specialist will outweigh the expected benefits in terms of audit quality.
The final amendments, however, mitigate this risk in several respects. In particular, the final amendments do not require the auditor to use the work of an auditor's specialist. Moreover, the final amendments regarding the nature, timing, and extent of the evaluation of the work of the company's specialist are designed to be risk-based and scalable to companies of varying size and complexity. In addition, as discussed above, the final amendments clarify the requirements for evaluating the work of a company's specialist and assessing the objectivity of an auditor-engaged specialist, which should avoid unnecessary effort by the auditor or auditor's specialist. Accordingly, any increases in effort should be accompanied by improvements in audit quality.

Potential Shift in the Balance Between the Work of a Company's Specialist and the Work of an Auditor's Specialist

In audit engagements involving specialists, the potential exists that the final amendments could affect the balance between the work of a company's specialist and the work of an auditor's specialist. The Proposal also identified this potential consequence, and some commenters expressed concern that companies might, in some instances, choose not to engage or involve a company's specialist if they expected that the auditor would use an auditor's specialist to perform additional procedures.¹⁸⁰

The final amendments do not change management's responsibility for the financial statements or their obligation to maintain effective internal control over financial reporting. Anticipating the use of an auditor's specialist for the audit

¹⁸⁰ See, e.g., Letter from Duff & Phelps (Aug. 30, 2017), at 4, available on the Board’s website in Docket 044 ("situations may arise where management may feel compelled to invest less time, costs and effort in supporting certain assertions in the financial statements by not engaging a specialist when one would otherwise be called for—especially given the expectation that the auditor's specialist would perform extensive testing and calculations as part of the audit").
engagement, however, some issuers may decide to use a company's specialist to a lesser extent (or not at all) when preparing financial statements and some company specialists may exhibit a reduced sense of responsibility. In such instances, the auditor's specialist may have to perform more work in order to adequately evaluate potential audit evidence provided by the issuer, including the work of a company's specialist if the issuer continues to use such a specialist. Alternatively the auditor may decide not to use the work of a company's specialist or use that work to a lesser extent. If the situations described above were to occur, audit quality might be reduced, not enhanced, in some instances.

The change in the balance between the work of a company's specialist and the work of an auditor's specialist, however, would likely be limited, as companies control the work of a company's specialist over information to be used in the financial statements, but lack similar control over an auditor's specialist. Companies generally are likely, therefore, to prefer to continue their use of a company's specialist. In addition, the final amendments do not require auditors to use an auditor's specialist when using the work of a company's specialist. Moreover, compared to the Proposal, the final amendments clarify the requirements for evaluating the work of a company's specialist. For example, the final amendments clarify the auditor's responsibilities for evaluating the methods and significant assumptions used by the company's specialist, and limit the use of the term "test" to procedures applied to company-produced information used by the specialist. These clarifications should alleviate concerns expressed by certain commenters.

**Potential Reduction in the Availability of Specialists**
Some commenters on the Proposal suggested that the proposed amendments, if adopted, would not affect the pool of qualified specialists available to serve as auditors' specialists. Other commenters, however, expressed concern that the proposed amendments might result in a shortage of, or strains on, the pool of qualified auditors' specialists, especially in situations where an audit firm currently uses the work of a company's specialist, but does not concurrently use an auditor's specialist.\textsuperscript{181} Situations that involved the auditor's use of the work of a company's specialist, but did not concurrently involve the use of an auditor's specialist, comprised a small percentage of audit engagements, ranging from 6\% to 10\% of the audit engagements of smaller and larger audit firms—U.S. and non-U.S.—that were selected for inspection in 2017 (category (1) of Figure 5 above).

Similar to the proposed amendments, the final amendments do not require auditors to use an auditor's specialist when using the work of a company's specialist. Moreover, in comparison to the proposed amendments, auditors are allowed under the final amendments to assess the objectivity of an auditor-engaged specialist along a spectrum, rather than make a binary determination whether they can use the work of an auditor-engaged specialist.\textsuperscript{182} This change should also reduce the possibility of a shortage

\begin{itemize}
\item Commenters did not specify whether such shortages would be permanent, or instead would reflect a temporary disruption to which the market would adjust over time.
\item Additionally, the final amendments provide for the auditor to evaluate along a spectrum the company's ability to significantly affect the judgments of the company's specialist. Furthermore, as discussed above, the final amendments reflect changes to the Proposal relating to the evaluation of the data, significant assumptions, and methods used by the company's specialist that clarify that the focus of the auditor's evaluation does not require the auditor to reperform the specialist's work.
\end{itemize}
of qualified auditors' specialists. Accordingly, the Board believes that the final amendments should not result in a shortage of, or strains on, the pool of qualified specialists available to serve as auditors' specialists.

**Alternatives Considered, Including Key Policy Choices**

The development of the final amendments involved considering a number of alternative approaches to address the problems described above. This subsection explains: (1) why standard setting is preferable to other policy-making approaches, such as providing interpretive guidance or enhancing inspection or enforcement efforts; (2) other standard-setting approaches that were considered by the Board; and (3) key policy choices made in determining the details of the proposed standard-setting approach.

*Why Standard Setting Is Preferable to Other Policy-Making Approaches*

The Board's policy tools include alternatives to standard setting, such as issuing additional interpretive guidance or an increased focus on inspections or enforcement of existing standards. One commenter stated that the Board should be proactive and supported the Board's preference for standard setting over other policy tools, while other commenters noted that other policy tools, such as the issuance of staff guidance and inspections activity, should also be considered.

While other policy tools may complement auditing standards, the Board has determined that providing additional guidance or increasing its inspection or enforcement efforts, without also amending the existing requirements regarding the auditor's responsibilities for using the work of specialists, would not be effective corrective mechanisms to address concerns with the evaluation of the work of a company's specialist, the supervision of an auditor's specialists, and the sources of market failure.
discussed previously. In addition, while devoting additional resources to such activities might focus auditors' attention on existing requirements, it would not provide the benefits associated with improving the standards discussed above. Thus, the final approach reflects the conclusion that standard setting is needed to fully achieve the benefits resulting from improvement in audits involving specialists. The Board will, however, monitor the implementation of the final amendments by audit firms and, if appropriate, consider the need for additional guidance.

**Other Standard-Setting Alternatives Considered**

Several alternative standard-setting approaches were also considered, including:

1. retaining the existing framework but requiring the auditor to disclose when the auditor used the work of specialists in the audit; or
2. targeted amendments to existing requirements.

**Disclosing When the Work of a Specialist is Used**

As an alternative to amending AS 1105 and AS 1201 and replacing existing AS 1210 in its entirety, the Board considered amending existing AS 1210 to remove the current limitations in existing AS 1210.15 on disclosing that a specialist was involved in the audit. Under this approach, the auditor would have been required to disclose this fact. Investors might benefit from such a requirement, since it would inform investors, at a minimum, that the auditor had evaluated the need for specialized skill or knowledge in order to perform an audit in accordance with PCAOB standards. Such disclosures could, in theory, positively affect audit practice, as auditors might face more scrutiny from investors regarding their decisions whether or not to use specialists.
Disclosure alone, however, would be unlikely to achieve the Board's objectives, which includes effecting more consistently rigorous practices among auditors when using the work of a company's specialist in their audits, as well as effecting a more consistent approach to the supervision of auditor-employed and auditor-engaged specialists. For example, with disclosure alone, some auditors might not evaluate the significant assumptions and methods of a company's specialist, even in higher risk audit areas.

Moreover, in a separate rulemaking, the Board has adopted a new auditing standard that requires the auditor to communicate CAMs in the auditor's report. A CAM is defined as any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that relates to accounts or disclosures that were material to the financial statements and involved especially challenging, subjective, or complex auditor judgment.\(^{183}\) Depending on the circumstances, the description of such CAMs might include a discussion of the work or findings of a specialist. While it is not yet clear how frequently the use of the work of specialists will be disclosed in the auditor's report as part of CAMs, these disclosure requirements are complemented by amending AS 1105 and AS 1201 and replacing existing AS 1210 to improve performance requirements over the use of the work of specialists. As discussed above, this should directly mitigate auditor moral hazard and change certain elements of audit practice observed by PCAOB oversight activities that have given rise to concern, such as situations where auditors did not apply appropriate professional skepticism when using the work of specialists.

Targeted Amendments to Existing Requirements for Using the Work of an Auditor's Specialists

The Board considered, but is not adopting, two alternative approaches for an auditor's use of the work of an auditor's specialist, as discussed in further detail in the Proposal. The first alternative was to develop a separate standard for using the work of an auditor's specialist. This approach would have created a new auditing standard for using the work of an auditor's specialist, whether employed or engaged by the auditor, similar to the approach in ISA 620 and AU-C Section 620 (and thereby separating the requirements for using the work of an auditor-engaged specialist from those for using the work of a company's specialist). One commenter on the Proposal supported this approach. The second alternative was to extend the supervisory requirements in AS 1201 to an auditor-engaged specialist. This approach would have amended existing AS 1210 to remove all references to an auditor-engaged specialist and amended AS 1201 to include all arrangements involving auditor-employed and auditor-engaged specialists.

Given the similar role of an auditor-employed and an auditor-engaged specialist in the audit, the Board determined that the auditor's procedures for reaching an understanding with the specialist and evaluating the work to be performed by the specialist should be similar. Accordingly, the Board has adopted separate, but parallel, requirements for using the work of an auditor-employed specialist and an auditor-engaged specialist related to reaching an understanding and evaluating the work to be performed. However, as discussed above, the auditor's relationship to an auditor-employed specialist differs in certain respects from the auditor's relationship to an auditor-engaged specialist, which may affect the auditor's visibility into the specialist's knowledge, skill, and ability, as well as into any relationships that might affect the
specialist's independence or objectivity. Accordingly, the final amendments address these differences by requiring the auditor to perform procedures in AS 1210, as amended, to evaluate the knowledge, skill, ability, and objectivity of auditor-engaged specialists, while recognizing that the auditor evaluates the knowledge, skill, ability, and independence of auditor-employed specialists in accordance with the same requirements that apply to other engagement team members.

**Key Policy Choices**

Given the preference for creating separate requirements for using a company's specialist, an auditor-employed specialist, and an auditor-engaged specialist, the Board considered different approaches to addressing key policy issues.

**Scope of the Final Amendments**

The Board considered a variety of possible approaches to the scope of the final amendments, including the treatment of persons with specialized skill or knowledge in certain areas of IT and income taxes. See section C for a discussion of the Board's considerations. In particular, after considering comments on the Proposal, the Board has clarified the scope and application of the final amendments in the rule text and discussion in its adopting release. The Board, while mindful of advances in technology that could fundamentally impact the audit process (and hence what is understood to be skill and knowledge in specialized areas of accounting and auditing), believes that the final amendments are sufficiently principles-based and flexible to accommodate continued technological advances that could impact audit practice in the future.

**Evaluating the Work of a Company's Specialist**

The Board considered a variety of possible approaches relating to the auditor's
evaluation of the work of a company's specialist. See section C for a discussion of the Board's considerations. In particular, after considering the comments on the Proposal, the Board is retaining the fundamental approach in the Proposal, under which the auditor evaluates the data, significant assumptions, and methods used by the specialist. The final amendments, including the revisions to the proposed requirements described in section C, retain the benefits resulting from the use of a risk-based audit approach, while at the same time directing the auditor to consider the quality of the source of information when determining his or her audit approach.

Evaluating the Qualifications and Independence of the Auditor-Employed Specialist

The Board considered a variety of possible approaches to evaluating the knowledge, skill, ability, and independence of auditor-employed specialists. See section C for a discussion of the Board's considerations. In particular, after considering the comments on the Proposal, the Board eliminated from the final amendments certain paragraphs that could have been misinterpreted as suggesting a different process for evaluating the qualifications and independence of auditor-employed specialists than for other engagement team members. Instead, the final amendments acknowledge that an auditor-employed specialist is a member of the engagement team and that existing requirements for assessing the qualifications and independence of engagement team members apply equally to auditor-employed specialists.

Assessing the Qualifications and Objectivity of the Auditor-Engaged Specialist

The Board considered a variety of possible approaches to assessing the knowledge, skill, ability, and objectivity of auditor-engaged specialists. See section C for a discussion of the Board's considerations. In particular, after considering the comments,
the Board made revisions in adopting the requirements described in section C to allow auditors to assess the objectivity of auditor-engaged specialists along a spectrum, rather than make a binary determination. The Board believes the final amendments in this area should limit any incremental cost to circumstances where increases in audit quality can be reasonably expected and thereby mitigate any adverse economic impact from potential unintended consequences of the final amendments. For example, requiring the auditor to perform additional procedures to evaluate the data, significant assumptions, and methods used by the specialist when the specialist has a relationship with the company that affects the specialist's objectivity should increase audit quality and reduce the risk that a material misstatement could go undetected.

Special Considerations for Audits of Emerging Growth Companies

Pursuant to Section 104 of the Jumpstart Our Business Startups ("JOBS") Act, rules adopted by the Board subsequent to April 5, 2012, generally do not apply to the audits of EGCs, unless the SEC "determines that the application of such additional requirements is necessary or appropriate in the public interest, after considering the protection of investors, and whether the action will promote efficiency, competition, and capital formation." As a result of the JOBS Act, the rules and related amendments to PCAOB standards the Board adopts are generally subject to a separate determination by the SEC regarding their applicability to audits of EGCs.

See Pub. L. No. 112-106 (Apr. 5, 2012). See Section 103(a)(3)(C) of the Sarbanes-Oxley Act, as added by Section 104 of the JOBS Act. Section 104 of the JOBS Act also provides that any rules of the Board requiring (1) mandatory audit firm rotation or (2) a supplement to the auditor's report in which the auditor would be required to provide additional information about the audit and the financial statements of the issuer (auditor discussion and analysis) shall not apply to an audit of an EGC. The final amendments do not fall within either of these two categories.
The Proposal sought comment on the applicability of the proposed requirements to audits of EGCs. Commenters generally supported applying the proposed requirements to audits of EGCs. These commenters asserted that consistent requirements should apply for similar situations encountered in any audit of a company, whether that company is an EGC or not, as well as that the benefits described in the Proposal would be applicable to EGCs. One commenter suggested "phasing" the implementation of the requirements for such audits to reduce the compliance burden.

The Board also notes that any new PCAOB standards and amendments to existing standards determined not to apply to the audits of EGCs would require auditors to address the differing requirements within their methodologies, which would also create the potential for confusion.

To inform consideration of the application of auditing standards to audits of EGCs, the PCAOB staff has also published a white paper that provides general information about characteristics of EGCs. As of the November 15, 2017 measurement date, the PCAOB staff identified 1,946 companies that had identified themselves as EGCs in at least one SEC filing since 2012 and had filed audited financial statements with the SEC in the 18 months preceding the measurement date.

Overall, the discussion of benefits, costs, and unintended consequences above is generally applicable to audits of EGCs. EGCs generally tend to have shorter financial reporting histories than other exchange-listed companies. As a result, there is less

See PCAOB white paper, Characteristics of Emerging Growth Companies as of November 15, 2017 (Oct. 11, 2018) (“EGC White Paper”), available on the Board’s website.
information available to investors regarding such companies relative to the broader population of public companies.\(^{186}\)

Although the degree of information asymmetry between investors and company management for a particular issuer is unobservable, researchers have developed a number of proxies that are thought to be correlated with information asymmetry, including small issuer size, lower analyst coverage, larger insider holdings, and higher research and development costs.\(^{187}\) To the extent that EGCs exhibit one or more of these properties, there may be a greater degree of information asymmetry for EGCs than for the broader population of companies, which increases the importance to investors of the external audit to enhance the credibility of management disclosures.\(^ {188}\) The final amendments relating to the auditor's use of the work of specialists, which are intended to enhance audit quality, could contribute to an increase in the credibility of financial statement disclosures by EGCs.

\(^{186}\) Id.


\(^{188}\) See, e.g., Molly Mercer, *How Do Investors Assess the Credibility of Management Disclosures?*, 18 Accounting Horizons 185, 189 (2004) ("[Academic studies] provide archival evidence that external assurance from auditors increases disclosure credibility...These archival studies suggest that bankers believe audits enhance the credibility of financial statements...").
When confronted with information asymmetry, investors may require a larger risk premium, and thus increase the cost of capital to companies.\textsuperscript{189} Reducing information asymmetry, therefore, can lower the cost of capital to companies, including EGCs, by decreasing the risk premium required by investors.\textsuperscript{190}

Furthermore, an analysis by PCAOB staff, the results of which are summarized in Figure 6 below, suggests that the prevalence and significance of the use of the work of specialists in audits of EGCs is comparable to the prevalence and significance of the use of the work of specialists in audits of non-EGCs, for audit engagements by both smaller audit firms and larger audit firms.\textsuperscript{191}

\textsuperscript{189} See supra notes 165 and 167.

\textsuperscript{190} For a discussion of how increasing reliable public information about a company can reduce risk premium, see David Easley and Maureen O'Hara, \textit{Information and the Cost of Capital}, 59 The Journal of Finance 1553 (2004).

\textsuperscript{191} The staff analysis was based on engagement-level data from the subset of 74 audit engagements of EGCs by U.S. and non-U.S. audit firms that were selected for inspection in 2017 presented above.
As indicated in Figure 6, the staff analysis observed that 41 (or about 55%) of the audit engagements were performed by U.S. and non-U.S., smaller audit firms. Among those 41 audit engagements, only four (or about 10%) involved the use of the work of a company's specialist but did not concurrently involve the use of the work of an auditor's specialist (category (1) above). In comparison, 33 of the 41 audit engagements (or about 80%) did not involve the use of the work of either a company's specialist or an auditor's specialist.

The audit engagements not included in the preceding three categories were included in the fourth category.

The total for the values shown in categories (1) through (4) may not add to 100% due to rounding.

192 The audit engagements not included in the preceding three categories were included in the fourth category.

193 The total for the values shown in categories (1) through (4) may not add to 100% due to rounding.
specialist (category (4) above) and four of the 41 audit engagements (or about 10%) involved the use of both a company's specialist and an auditor's specialist (category (3) above). In none of those 41 audit engagements did the auditor use the work of an auditor's specialist without also concurrently using the work of a company's specialist (category (2) above). Among the 33 audit engagements of EGCs (or about 45%) performed by larger firms, both U.S. and non-U.S. firms, one (or about 3%) involved the use of the work of a company's specialist but did not concurrently involve the use of the work of an auditor's specialist (category (1) above); 19 (or about 58%) did not involve the use of the work of either a company's specialist or an auditor's specialist (category (4) above); nine (or about 27%) involved the use of both a company's specialist and an auditor's specialist (category (3) above); and four (or about 12%) involved the use of the work of an auditor's specialist, but did not concurrently involve the use of work of a company's specialist (category (2) above).

Thus, the Board believes that the need for the final amendments discussed earlier and the associated benefits of the final amendments generally apply also to audits of EGCs.

While for small companies (including EGCs), even a small increase in audit fees could negatively affect their profitability and competitiveness, many EGCs are expected to experience minimal impact from the final amendments. In particular, some EGCs do not use a company's specialist and, for those EGCs that do use a company's specialist, the final amendments relating to the auditor's use of the work of such specialists are risk-based and designed to be scalable to companies of varying size and complexity.
In addition, the analysis presented in the EGC White Paper observed that about 40% of audits of EGCs are performed by firms that provided audit reports for more than 100 issuers and were required to be inspected on an annual basis by the PCAOB.\(^{194}\) These firms tend to already have practices for using the work of specialists that are consistent with many or all elements of the final amendments. For such audit firms, the costs on a per engagement basis of adopting the final amendments should also be low, for the reasons discussed above.

For the other 60% of audits of EGCs, the PCAOB staff analysis summarized in Figure 6 above suggests that the proportion of EGC audit engagements that involve the use of the work of company specialists, but do not involve the use of the work of an auditor's specialist, is small and comparable to the proportion of similar issuer audit engagements described previously. As discussed above, auditors on such audit engagements may experience the most significant cost impact of the final amendments. However, only a small proportion of audits of EGCs are expected to be significantly affected by the final amendments. In addition, the final amendments clarify the requirements for evaluating the work of a company's specialist and assessing the objectivity of an auditor-engaged specialist, which should avoid unnecessary effort by the auditor or auditor's specialist. Accordingly, any increase in effort should be accompanied by improvements in audit quality.

The Board has provided this analysis to assist the SEC in its consideration of whether it is "necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and

\(^{194}\) See EGC White Paper, at 3.
capital formation," to apply the final amendments to audits of EGCs. This information includes data and analysis of EGCs identified by the Board's staff from public sources.

For the reasons explained above, the Board believes that the final amendments are in the public interest and, after considering the protection of investors and the promotion of efficiency, competition, and capital formation, recommends that the final amendments should apply to audits of EGCs. Accordingly, the Board recommends that the Commission determine that it is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation, to apply the final amendments to audits of EGCs. The Board stands ready to assist the Commission in considering any comments the Commission receives on these matters during the Commission's public comment process.

Applicability to Audits of Brokers and Dealers

The Proposal indicated that the proposed amendments would apply to audits of brokers and dealers, as defined in Sections 110(3)-(4) of the Sarbanes-Oxley Act. The Board solicited comment on any factors specifically related to audits of brokers and dealers that may affect the application of the proposed amendments to those audits. Commenters that addressed the issue agreed that amendments to the standards for the auditor's use of the work of specialists should apply to these audits, citing benefits to users of financial statements of brokers and dealers and the risk of confusion and inconsistency if different methodologies were required under PCAOB standards for audits of different types of entities.

After considering comments, the Board determined that the final amendments, if approved by the SEC, will be applicable to all audits performed pursuant to PCAOB
standards, including audits of brokers and dealers. The Board's determination is based on the observation that the information asymmetry between the management of brokers and dealers and their customers about the brokers' and dealers' financial condition may be significant and of particular interest to customers, as a broker or dealer may have custody of customer assets, which could become inaccessible to the customers in the event of the insolvency of the broker or dealer.

In addition, unlike the owners of brokers and dealers, who themselves may be managers and thus be subject to minimal or no information asymmetry, customers of brokers and dealers may, in some instances, be large in number and may not be expert in the management or operation of brokers and dealers. Such information asymmetry between the management and the customers of brokers and dealers makes the role of auditing important to enhance the reliability of financial information.

Accordingly, the discussion above of the need for the final amendments, as well as the costs, benefits, alternatives considered and potential unintended consequences to auditors and the companies they audit, also applies to audits of brokers and dealers. In particular, PCAOB staff analysis of inspections data for audits of brokers and dealers indicates that auditors of brokers and dealers do not frequently use the work of specialists, whether company specialists or an auditor's specialists.\textsuperscript{195} Hence, the results suggest that only a small percentage of audits of brokers and dealers will be impacted by

\textsuperscript{195} The staff analysis is based on 116 audit engagements of brokers and dealers performed by audit firms that were selected for inspection in 2017. The results of the analysis found that the auditor did not use the work of a specialist in about 90% of the broker or dealer audits. This analysis also found that auditors used the work of at least one auditor's specialist in about 8% of the audits analyzed and used the work of at least one company specialist in about 2% of those audits.
the final amendments. In addition, with respect to the impact of the final amendments on customers of brokers and dealers, the expected improvements in audit quality described previously would benefit such customers, along with investors, capital markets and auditors, while the final requirements are not expected to result in any direct costs or unintended consequences to customers of brokers and dealers.

III. Date of Effectiveness of the Proposed Rules and Timing for Commission Action

Pursuant to Section 19(b)(2)(A)(ii) of the Exchange Act, and based on its determination that an extension of the period set forth in Section 19(b)(2)(A)(i) of the Exchange Act is appropriate in light of the PCAOB’s request that the Commission, pursuant to Section 103(a)(3)(C) of the Sarbanes-Oxley Act, determine that the proposed rules apply to the audits of EGCs, the Commission has determined to extend to [insert date 90 days after the date of publication in the Federal Register] the date by which the Commission should take action on the proposed rules.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rules are consistent with the requirements of Title I of the Act. Comments may be submitted by any of the following methods:
Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/pcaob.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number PCAOB-2019-03 on the subject line.

Paper comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number PCAOB-2019-03. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/pcaob.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rules that are filed with the Commission, and all written communications relating to the proposed rules between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing will also be available for inspection and copying at the principal office of the PCAOB. All comments received will be posted without charge. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions
should refer to File Number PCAOB-2019-03 and should be submitted on or before [INSERT DATE 21 DAYS FROM PUBLICATION IN THE FEDERAL REGISTER].

For the Commission, by the Office of the Chief Accountant, by delegated authority.¹⁹⁶

Eduardo A. Aleman,

Deputy Secretary.

¹⁹⁶ 17 CFR 200.30-11(b)(1) and (3).