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SECURITIES AND EXCHANGE COMMISSION
[Release No. 34-86270; File No. PCAOB-2019-006]

Public Company Accounting Oversight Board; Order Granting Approval of Amendments to Auditing Standards for Auditor's Use of the Work of Specialists

July 1, 2019

I. Introduction

On March 20, 2019, the Public Company Accounting Oversight Board (the “Board” or the “PCAOB”) filed with the Securities and Exchange Commission (the “Commission”), pursuant to Section 107(b)¹ of the Sarbanes-Oxley Act of 2002 (the “Sarbanes-Oxley Act”) and Section 19(b)² of the Securities Exchange Act of 1934 (the “Exchange Act”), a proposal to adopt amendments to auditing standards for auditor’s use of the work of specialists (collectively, the “Proposed Rules”).³ The Proposed Rules were published for comment in the Federal Register on April 4, 2019.⁴ At the time the notice was issued, the Commission extended to July 3, 2019 the date by which the Commission should take action on the Proposed Rules.⁵ We received four comment letters in response to the notice.⁶ This order approves the Proposed Rules, which we find to be

¹ 15 U.S.C. 7217(b).

² 15 U.S.C. 78s(b).

³ The PCAOB staff originally issued a staff consultation paper on this matter in 2015. See The Auditor’s Use of the Work of Specialists, PCAOB Staff Consultation Paper No. 2015-01 (May 28, 2015), available at https://pcaobus.org/Standards/Documents/SCP-2015-01_The_Auditor’s_Use_of_the_Work_of_Specialists.pdf. In 2017, the Board issued a proposed rule. See Proposed Amendments to Auditing Standards for Auditor’s Use of the Work of Specialists, PCAOB Release No. 2017-003 (June 1, 2017) (“PCAOB Proposal”), available at <https://pcaobus.org/Rulemaking/Docket044/2017-003-specialists-proposed-rule.pdf>.

⁴ See Release No. 34-85435, *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*, (Mar. 28, 2019), 84 FR 13442 (Apr. 4, 2019).

⁵ See id.

⁶ We received comment letters from Deloitte & Touche LLP, April 10, 2019 (“Deloitte Letter”); the Council of Institutional Investors, April 18, 2019 (“CII Letter”); PricewaterhouseCoopers LLP, April 25, 2019 (“PwC Letter”);

consistent with the requirements of the Sarbanes-Oxley Act and the securities laws and necessary or appropriate in the public interest or for the protection of investors.

II. Description of the Proposed Rules

On December 20, 2018, the Board adopted amendments to auditing standards for using the work of specialists.⁷ The Proposed Rules are intended to strengthen the requirements that apply when auditors use the work of specialists in an audit.⁸ The Proposed Rules relate to an auditor's evaluation of the work of a company's specialist, whether employed or engaged by the company, and apply a supervisory approach to both auditor-employed and auditor-engaged specialists.

A. Changes to PCAOB Standards

The Proposed Rules primarily amend two existing PCAOB auditing standards and retitle and replace a third auditing standard.⁹ The Proposed Rules will make the following changes to existing requirements:

and the Center for Capital Markets Competitiveness, U.S. Chamber of Commerce, April 25, 2019 ("CCMC Letter"). Copies of the comment letters received on the Commission order noticing the Proposed Rules are available on the Commission's website at <https://www.sec.gov/comments/pcaob-2019-03/pcaob201903.htm>.

⁷ See *Amendments to Auditing Standards for Auditor's Use of the Work of Specialists*, PCAOB Release No. 2018-006 (Dec. 20, 2018) ("PCAOB Adopting Release"), available at <https://pcaobus.org/Rulemaking/Docket044/2018-006-specialists-final-rule.pdf>.

⁸ In the Proposed Rules, a specialist is defined generally as a person (or firm) possessing special skill or knowledge in a particular field other than accounting or auditing.

⁹ The Proposed Rules: (1) add an appendix to Auditing Standard ("AS") 1105, *Audit Evidence*, with supplemental requirements for using the work of a company's specialist as audit evidence; (2) add an appendix to AS 1201, *Supervision of the Audit Engagement*, with supplemental requirements for supervising an auditor-employed specialist; and (3) replace existing AS 1210, *Using the Work of a Specialist*, with an updated standard titled, *Using the Work of an Auditor-Engaged Specialist*, for using the work of an auditor-engaged specialist.

- ***Amend AS 1105***
 - Adds a new Appendix A 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 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 standards¹⁰ and the standard and related amendments

¹⁰ The Board's "risk assessment standards" include AS 1101, *Audit Risk*; AS 1105; AS 1201; AS 2101, *Audit Planning*; AS 2105, *Consideration of Materiality in Planning and Performing an Audit*; AS 2110, *Identifying and Assessing Risks of Material Misstatement*; AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*; and AS 2810, *Evaluating Audit Results*.

adopted by the Board on auditing accounting estimates, including fair value measurements; and

- 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.

- ***Amend AS 1201***

- Adds 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 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.
- ***Replace existing AS 1210***
 - Replaces the existing standard with AS 1210, as amended, which 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 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.

B. Applicability and Effective Date

The Proposed Rules would be effective for audits of financial statements for fiscal years ending on or after December 15, 2020. The PCAOB has proposed application of the Proposed

Rules to include audits of emerging growth companies (“EGCs”),¹¹ as discussed in Section IV below, and audits of brokers and dealers under Exchange Act Rule 17a-5.

III. Comment Letters

The comment period on the Proposed Rules ended on April 25, 2019. We received four comment letters from accounting firms, an investor association, and an issuer organization.¹² Commenters generally supported the Proposed Rules.¹³ Most commenters encouraged us to support the PCAOB’s plans to monitor implementation, conduct post implementation review, or monitor advancements in technology that may affect application of the Proposed Rules.¹⁴ One commenter also raised concerns regarding the effective date due to other financial reporting activities that need to be implemented and the potential impact on smaller audit firms.¹⁵

The Sarbanes-Oxley Act requires us to determine whether the Proposed Rules are consistent with the requirements of the Sarbanes-Oxley Act and the securities laws or are necessary or appropriate in the public interest or for the protection of investors.¹⁶ In making this determination, we have considered the comments we received, as well as the feedback received and

¹¹ The term “emerging growth company” is defined in Section 3(a)(80) of the Exchange Act (15 U.S.C. 78c(a)(80)). See also Release No. 33-10332 *Inflation Adjustments and Other Technical Amendments Under Titles I and III of the JOBS Act* (Mar. 31, 2017), 82 FR 17545 (Apr. 12, 2017).

¹² See Deloitte Letter, PwC Letter, CII Letter, and CCMC Letter.

¹³ See Deloitte Letter, PwC Letter, CII Letter, and CCMC Letter.

¹⁴ See e.g., Deloitte Letter, PwC Letter, and CCMC Letter.

¹⁵ See CCMC Letter.

¹⁶ See Section 107(b)(3) of the Sarbanes-Oxley Act. The Sarbanes-Oxley Act also specifies that the provisions of Section 19(b) of the Exchange Act shall govern the proposed rules of the Board. See Section 107(b)(4) of the Sarbanes-Oxley Act. Section 19 of the Exchange Act covers the registration, responsibilities, and oversight of self-regulatory organizations. Under the procedures prescribed by the Sarbanes-Oxley Act and Section 19(b)(2) of the Exchange Act, the Commission must either approve or disapprove, or institute proceedings to determine whether the proposed rules of the Board should be disapproved; and these procedures do not expressly permit the Commission to amend or supplement the proposed rules of the Board.

modifications made by the PCAOB throughout its rulemaking process. The discussion below addresses the significant points raised in the comment letters we received.

A. General Support for the Proposed Rules

Commenters generally supported the Proposed Rules, including the objective to strengthen the requirements that apply when auditors use the work of specialists in an audit.¹⁷ One commenter noted that the proposed amendments address the need to differentiate, define, and provide scalability of the requirements based on the nature of a specialist's involvement in the context of an audit as well as the identified risk of material misstatement to which the specialist's work relates, which the commenter indicated will achieve greater consistency in practice.¹⁸ Another commenter agreed with the Board that the Proposed Rules will benefit investors "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."¹⁹

B. Implementation Efforts

Most commenters noted their desire for ongoing monitoring by the PCAOB if the Proposed Rules are approved.²⁰ Two commenters specifically supported the PCAOB's plan²¹ to monitor implementation, including advances in technology and any related effects on the application of the proposed amendments.²² Another commenter recommended that the Commission, as part of its

¹⁷ See Deloitte Letter, CII Letter, PwC Letter, and CCMC Letter.

¹⁸ See Deloitte Letter.

¹⁹ See CII Letter.

²⁰ See e.g., Deloitte Letter, PwC Letter, and CCMC Letter.

²¹ See PCAOB Adopting Release at 5 and 60.

²² See Deloitte Letter and CCMC Letter.

oversight of the PCAOB, should request that the PCAOB periodically update the Commission on the PCAOB's activities for monitoring the implementation of the Proposed Rules along with the PCAOB's findings and responses to these activities, including the PCAOB's plans for a post-implementation review.²³

In the PCAOB Adopting Release, the Board stated it would monitor implementation to determine whether additional interpretive guidance is necessary, including monitoring the advancement of technology.²⁴ In addition, the PCAOB has an established program to conduct post-implementation reviews of its rules and standards to evaluate the overall effect of significant rulemakings.²⁵

We acknowledge the importance of monitoring the implementation of the Proposed Rules. The Commission staff works closely with the PCAOB as part of our general oversight mandate.²⁶ As part of that oversight, Commission staff will keep itself apprised of the PCAOB's activities for monitoring the implementation of the Proposed Rules and update the Commission, as necessary.

A. The Effective Date of the Proposed Rules

As noted above, the Proposed Rules would be effective for audits of financial statements for fiscal years ending on or after December 15, 2020. One commenter expressed concerns related to the effective date as a result of other financial reporting activities, including upcoming effective dates of certain Financial Accounting Standards Board ("FASB") projects, other PCAOB

²³ See CCMC Letter.

²⁴ See PCAOB Adopting Release at 5 and 60.

²⁵ See PCAOB website at <https://pcaobus.org/EconomicAndRiskAnalysis/pir/Pages/default.aspx>.

²⁶ See Section 107 of the Sarbanes-Oxley Act.

standards, and a view that smaller audit firms may be disproportionately impacted.²⁷ The commenter suggested a phased implementation of the Proposed Rules. Specifically, the commenter recommended, as an example, that the Commission allow triennially inspected audit firms²⁸ to elect an effective date of audits for fiscal years ending on or after December 15, 2021, while also permitting earlier implementation since smaller audit firms may be disproportionately impacted.²⁹ The commenter further expressed the belief that a phased implementation may facilitate post-implementation reviews of the Proposed Rules.³⁰

In the PCAOB Adopting Release, the Board recognized the effort required for other implementation efforts, but stated the effective date determined by the Board was designed to provide auditors with a reasonable period of time to implement the Proposed Rules, without unduly delaying the intended benefits of the Proposed Rules.³¹

We believe the Board has appropriately balanced the amount of time needed by audit firms to implement the Proposed Rules with the objectives of, and benefits obtained from, the Proposed Rules. In this regard, we note that, aside from the commenter who suggested that the Commission consider a phased implementation approach, we received no other comments from audit firms, including triennially inspected audit firms, requesting a phased implementation.

In addition, there could be practical implications of allowing for a phased implementation

²⁷ See CCMC Letter.

²⁸ “Triennially inspected audit firms” are audit firms that, in accordance with PCAOB Rule 4003(b), are required to be inspected at least once in every three calendar years if during that time, the audit firm issued an audit report for at least one issuer but no more than 100 issuers. An audit firm is required to be inspected on an annual basis if during the prior calendar year, it issued audit reports for more than 100 issuers (“annually inspected audit firms”). See PCAOB Rule 4003, *Frequency of Inspections*, available at https://pcaobus.org/Rules/Pages/Section_4.aspx.

²⁹ See CCMC letter.

³⁰ See *id.*

³¹ See PCAOB Adopting Release at 71.

approach related to an auditor performance standard.³² For example, audits of multi-national companies often involve the work of more than one auditor conducted in accordance with AS 1205, *Part of the Audit Performed by Other Independent Auditors* (“AS 1205”), wherein a principal auditor may provide instructions to the other auditors. Under a phased implementation approach, an annually inspected audit firm serving as the principal auditor may instruct a triennially inspected audit firm to follow the Proposed Rules before the triennially inspected audit firm has implemented the Proposed Rules. This approach could create challenges for the triennially inspected audit firm as it would be instructed to implement the Proposed Rules on individual engagements even though it may not have updated its methodologies or trained its professionals on the Proposed Rules, which could have a negative effect on audit quality.

Further, within the Global Networks of accounting firms,³³ many of the affiliated accounting firms outside the United States are triennially inspected audit firms. Many of these affiliated firms participate in the multi-national audits discussed above. Our understanding is that these arrangements make it more practical for the Global Network Firms to adopt the Proposed Rules simultaneously across their respective networks. As a result, the Global Network Firms may not delay implementation for the triennially inspected audit firms within their network.

Based on these considerations, we do not believe a phased implementation approach for the Proposed Rules, including providing triennially inspected audit firms with the option to delay implementation, is necessary or appropriate in the public interest or for the protection of investors.

³² The CCMC Letter references differences in considering a phased implementation approach for auditor performance standard as compared to an auditor reporting standard, which is why it did not suggest a phased implementation approach based on issuer size similar to the auditor communicating critical audit matters in accordance with AS 3101, *The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*.

³³ See PCAOB website for a listing of “Global Networks” and further discussion, [available at https://pcaobus.org/Registration/Firms/Pages/GlobalNetworkFirms.aspx](https://pcaobus.org/Registration/Firms/Pages/GlobalNetworkFirms.aspx).

IV. Effect on Emerging Growth Companies

In the PCAOB Adopting Release, the Board recommended that the Commission determine that the Proposed Rules apply to audits of EGCs.³⁴ Section 103(a)(3)(C) of the Sarbanes-Oxley Act, as amended by Section 104 of the Jumpstart Our Business Startups Act of 2012, requires that any rules of the Board “requiring mandatory audit firm rotation or 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 provisions of the Proposed Rules do not fall into these categories.

Section 103(a)(3)(C) further provides that “[a]ny additional rules” adopted by the PCAOB after April 5, 2012, do not apply to audits of EGCs “unless the Commission 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.” The Proposed Rules fall within this category. Having considered those statutory factors, we find that applying the Proposed Rules to the audits of EGCs is necessary or appropriate in the public interest.

The PCAOB provided information identified by the Board’s staff from public sources, including data and analysis of EGCs that set forth its views as to why it believes the Proposed Rules should apply to audits of EGCs. To inform consideration of the application of auditing standards to audits of EGCs, the PCAOB staff published a white paper that provides general

³⁴ See PCAOB Adopting Release at 69.

information about characteristics of EGCs (“EGC White Paper”).³⁵ In addition, the Board sought public input on the application of the Proposed Rules to the audits of EGCs.³⁶ Commenters who addressed this question generally supported applying the Proposed Rules to audits of EGCs, citing that consistent requirements should apply for similar situations encountered in any audit of a company, whether the company is an EGC or not, as well as that the benefits described in the Proposal would be applicable to EGCs.³⁷

As the Board observed in the PCAOB Adopting Release, “an analysis by the PCAOB staff...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.”³⁸ Additionally, the PCAOB Adopting Release noted 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.”³⁹ In the EGC White Paper, the PCAOB staff stated that “[a]pproximately 99% of EGC filers were audited by accounting firms that also audit issuers that are not EGC filers.”⁴⁰ As a result, there is a potential for confusion and complexity to have auditors maintain two sets of methodologies related to using work of specialists.

³⁵ See *Characteristics of Emerging Growth Companies as of November 15, 2017* (Oct. 11, 2018), [available at](https://pcaobus.org/EconomicAndRiskAnalysis/Documents/White-Paper-Characteristics-Emerging-Growth-Companies-November-2017.pdf) <https://pcaobus.org/EconomicAndRiskAnalysis/Documents/White-Paper-Characteristics-Emerging-Growth-Companies-November-2017.pdf>.

³⁶ See PCAOB Proposal; see also comment letters provided to the PCAOB related to this matter, [available at](https://pcaobus.org/Rulemaking/Pages/docket-044-comments-auditors-use-work-specialists.aspx) <https://pcaobus.org/Rulemaking/Pages/docket-044-comments-auditors-use-work-specialists.aspx>.

³⁷ See PCAOB Adopting Release at 64.

³⁸ See *id.* at 66.

³⁹ See *id.* at 64.

⁴⁰ See EGC White Paper at 20.

The Board recognized that even a small increase in audit fees could negatively affect the profitability and competitiveness of EGCs. However, the PCAOB Adopting Release notes that many EGCs are expected to experience minimal impact from the Proposed Rules. For example, for those EGCs that use a company specialist,⁴¹ the Proposed Rules 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.⁴²

The PCAOB Adopting Release also noted EGCs generally tend to have shorter financial reporting histories and as a result, there is less information available to investors regarding such companies relative to the broader population of public companies.⁴³ As such, the Proposed Rules, which are intended to enhance audit quality, could increase the credibility of financial statement disclosures by EGCs.⁴⁴

We agree with the Board's analysis. We believe the Proposed Rules will benefit EGCs at least as much as non-EGCs, in part, because 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. In addition, we agree with the Board that, given the scalability and risk-based nature of the new audit requirements, EGCs likely will experience only minimal cost impacts from the Proposed Rules. Finally, we also agree with the Board the Proposed Rules could increase the credibility of financial statement disclosures by EGCs.

⁴¹ See PCAOB Adopting Release at 50, which discusses that the most significant impact on the final amendments related to costs for auditors is expected to result from the requirements to evaluate the work of a company's specialist.

⁴² See id at 68.

⁴³ See id at 65.

⁴⁴ See id at 66.

As such, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation, we believe there is a sufficient basis to determine that applying the Proposed Rules to the audits of EGCs is necessary or appropriate in the public interest.

V. Conclusion

The Commission has carefully reviewed and considered the Proposed Rules, the information submitted therewith by the PCAOB, and the comment letters received. In connection with the PCAOB's filing and the Commission's review,

A. The Commission finds that the Proposed Rules are consistent with the requirements of the Sarbanes-Oxley Act and the securities laws and are necessary or appropriate in the public interest or for the protection of investors; and

B. Separately, the Commission finds that the application of the Proposed Rules to the audits of EGCs 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.

IT IS THEREFORE ORDERED, pursuant to Section 107 of the Sarbanes-Oxley Act and Section 19(b)(2) of the Exchange Act, that the Proposed Rules (File No. PCAOB-2019-006) be and hereby are approved.

By the Commission.

Eduardo A. Aleman,
Deputy Secretary.

[FR Doc. 2019-14414 Filed: 7/5/2019 8:45 am; Publication Date: 7/8/2019]