

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-90930; File No. PCAOB-2020-01]

January 14, 2021

Public Company Accounting Oversight Board; Order Granting Approval of Amendments to PCAOB Interim Independence Standards and PCAOB Rules to Align with Amendments to Rule 2-01 of Regulation S-X

I. Introduction

On November 20, 2020, 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 the PCAOB’s interim independence standards and PCAOB rules to align with the Commission’s recent adoption of amendments 17 CFR 210.2-01 (“Rule 2-01”) of 17 CFR 210.01 *et seq.* (“Regulation S-X”)³ (collectively, the “Proposed Rules”).⁴ The Proposed Rules were published for comment in the Federal Register on November 27, 2020.⁵ We received several comment letters in response to the notice.⁶ This order approves the Proposed

¹ 15 U.S.C. 7217(b).

² 15 U.S.C. 78s(b).

³ See *Qualifications of Accountants*, Release No. 33-10876 (Oct. 16, 2020) (“2020 Adopting Release”).

⁴ See *Amendments to PCAOB Interim Independence Standards and Board Rules to Align with Amendments to Rule 2-01 of Regulation S-X*, PCAOB Release No. 2020-03 (Nov. 19, 2020) (“PCAOB Adopting Release”), available at <https://pcaobus.org/Rulemaking/Docket047/2020-003-Independence-final-rule.pdf>.

⁵ See *Public Company Accounting Oversight Board; Notice of Filing of Proposed Rules on Amendments to PCAOB Interim Independence Standards and PCAOB Rules to Align with Amendments to Rule 2-01 of Regulation S-X*, Release No. 34-90473 (Nov. 20, 2020) [85 FR 76131 (Nov. 27, 2020)].

⁶ See, e.g., comment letters from the Council of Institutional Investors, December 3, 2020 (“CII Letter”); Right Advisory LLC, December 7, 2020 (“RA Letter”); Deloitte LLP, December 11, 2020 (“Deloitte Letter”);

Rules, which we find to be 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 November 19, 2020, the Board adopted amendments to the PCAOB’s interim independence standards and PCAOB rules to align with amendments by the SEC to Rule 2-01 of Regulation S-X.⁷ The Proposed Rules are intended to avoid differences and duplicative requirements. To that end, the Board adopted targeted amendments to its interim independence standards applicable to lending arrangements between auditors and audit clients. In addition, the Board adopted targeted amendments to align certain terms defined in PCAOB Rule 3501 with the Commission’s recent amendments to its definitions of those terms in 17 CFR 210.2-01(f) (“Rule 2-01(f”)).

A. Changes to PCAOB Standards

The Proposed Rules will make the following changes:

- Amend ET § 101.02 of the American Institute of Certified Public Accountants (“AICPA”) Code of Professional Conduct, *Interpretation of Rule 101*, as in

PricewaterhouseCoopers LLP, December 16, 2020 (“PwC Letter”); Colorado PERA, December 16, 2020 (“COPERA”); International Corporate Governance Network, December 16, 2020 (“ICGN Letter”); Consumer Federation of America and Certain Other Groups and Individuals, December 17, 2020 (“CFA, et al. Letter”); Ernst & Young LLP, December 18, 2020 (“EY Letter”); and the California Public Employees’ Retirement System, December 18, 2020 (“CalPERS 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-2020-01/pcaob202001.htm>.

⁷ See *supra* note 4.

existence on April 16, 2003 and incorporated in the Board’s auditing and related professional practice.

- Delete ET § 101.07 of the AICPA’s Code of Professional Conduct, *Loans from financial institution clients and related terminology*, as in existence on April 16, 2003 and incorporated in the Board’s auditing and related professional practice standards by PCAOB Rule 3500T.
- Delete ET §§ 191.150-.151, ET §§ 191.182-.183, ET §§ 191.196-.197, and ET §§ 191.220-.222, of the AICPA’s Code of Professional Conduct, as in existence on April 16, 2003 and incorporated in the Board’s auditing and related professional practice standards by PCAOB Rule 3500T, which are four Ethics Rulings under Rule 101 that also address lending arrangements and are part of the Board’s interim independence standards.
- Amend PCAOB Rules 3501(a)(ii), (a)(iii), and (i)(ii).

B. Applicability and Effective Date

The Proposed Rules will be effective June 9, 2021, 180 days after the date of the publication of the Commission’s October 16, 2020 amendments to Rule 2-01 in the Federal Register. The June 9, 2021 effective date is aligned with the effective date of the Commission’s amendments to Rule 2-01.⁸ Auditors may elect to comply before the effective date at any point after SEC approval of the Board’s amendments, provided that the final amendments are applied in their entirety. The PCAOB has recommended that the Proposed Rules to apply to audits of

⁸ See 2020 Adopting Release at 81.

emerging growth companies (“EGCs”),⁹ as discussed in Section IV below, and audits of brokers and dealers under 17 CFR 240.17a-5 (“Exchange Act Rule 17a-5”).

III. Comment Letters

The comment period on the Proposed Rules ended on December 18, 2020. We received several comment letters representing investor organizations, advisory firms, accounting firms, trade organizations, and other interested parties. Some commenters were supportive¹⁰ of the Proposed Rules while other commenters asked the Commission to consider certain changes to auditor independence unrelated to the Proposed Rules¹¹ or reiterated comments addressed by the Commission in the 2020 Adopting Release.¹²

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.¹³ In making this determination, we have considered the comments we received. The comments received on the Proposed Rules did not raise new issues for the Commission to address. The commenters in

⁹ 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).

¹⁰ See RA Letter; Deloitte Letter; PwC Letter; and EY Letter.

¹¹ See RA Letter.

¹² See CII Letter; CFA, et al. Letter.

¹³ 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 pertains to 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.

support of the Commission’s approval of the Proposed Rules reiterated their prior support for the 2020 Adopting Release and noted the benefits of eliminating differences between the Commission’s and the PCAOB’s auditor independence rules while focusing on those relationships and services that are more likely to threaten an auditor’s objectivity and impartiality.¹⁴ Commenters opposing the Commission’s approval of the Proposed Rules reiterated certain concerns regarding amendments in the Commission’s 2020 Adopting Release or expressed concerns about the PCAOB’s process to adopt the Proposed Rules at this time. For example, some commenters¹⁵ expressed concerns about the “Affiliate of the Audit Client” definition while one commenter¹⁶ broadly opposed many of the specific amendments within the Commission’s 2020 Adopting Release. Some commenters¹⁷ also expressed the desire for a rule that would specify the documentation that auditors should prepare and maintain when additional services are provided to an affiliate of an audit client.¹⁸ One commenter¹⁹ suggested a public certification of the design and operating effectiveness of controls over audit quality and independence by executives of the audit firm.²⁰ The commenters²¹ who expressed concerns

¹⁴ See Deloitte Letter; PwC Letter; EY Letter; RA Letter.

¹⁵ See CII Letter; CFA et al. Letter; and CalPERS Letter.

¹⁶ See CFA et al. Letter.

¹⁷ See *supra* note 15.

¹⁸ In considering a rule adopted by the PCAOB under the Sarbanes-Oxley Act, the Commission may only take action to approve or disapprove any such rule. As such, any recommendation to alter the Proposed Rules is outside the scope of this Order.

¹⁹ See *supra* note 11.

²⁰ See *supra* note 18.

²¹ See CFA et al Letter, COPERA Letter; ICGN Letter; and CalPERS Letter. One commenter specifically expressed concerns regarding the PCAOB relying on the Commission’s deliberation in adopting the 2020 Adopting Release. See CalPERS Letter. In the PCAOB Adopting Release, the Board noted its consideration of the Commission’s rulemaking record and stated that “[it] believes that this process – structured by the Commission to

about the PCAOB’s process to adopt the Proposed Rules at this time requested the PCAOB to use its independent authority to expand the scope of the rulemaking beyond conforming amendments to the Commission’s 2019 and 2020 Adopting Releases.

After considering the public comments and recommendations, we are approving the Proposed Rules. The comments the Commission has received with respect to the Proposed Rules are generally similar to the comments the Commission considered when approving the 2020 Adopting Release and the Auditor Independence with Respect to Certain Loans or Debtor-Creditor Relationships Release (the “2019 Adopting Release”).²² As the Commission noted in the 2020 Adopting Release, the Commission expects the amendments to Rule 2-01 to more effectively focus the independence analysis on those relationships or services that are more likely to pose threats to an auditor’s objectivity and impartiality. After considering public comments, the Commission noted that the amendments to Rule 2-01 would benefit audit firms, audit clients, and investors in several ways. First, by revising the rules to emphasize those relationships and services that are more likely to threaten auditor objectivity and impartiality, the Commission anticipates the amendments will reduce compliance costs for audit firms and their clients. Similarly, under the amended rules, auditors and their clients will be able to focus their resources and attention on monitoring those relationships and services that pose the greatest risk to auditor independence, reducing overall compliance burdens without significantly diminishing investor

satisfy the requirements of the Administrative Procedure Act – is at least as robust as the Board’s process would have been had the PCAOB considered amendments to the Board’s independence requirements without the benefit of the SEC’s analysis.” *See* PCAOB Adopting Release, at 12. The Board further noted that it did not perceive “any reason or compelling basis in the [Commission’s] rulemaking record” to diverge from the Commission’s stated goals and maintain disparate independence requirements. *Id.* Because we agree with the Board’s conclusions on these points, we are not persuaded by the commenter who objected to the PCAOB’s processes.

²² *See* Adopting Release, at 88-90.

protections.²³ The Proposed Rules, which conform the PCAOB’s independence requirements to the 2020 Adopting Release, will allow firms, audit clients and investors to take advantage fully of the anticipated benefits of the amendments to Rule 2-01.

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.²⁴ 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.

To inform consideration of the application of auditing standards to audits of EGCs,

²³ See Release No. 33-10648 (June 18, 2019), [84 FR 32040 (July 5, 2019)]. Some commenters explicitly cited to their prior comment letters submitted when the Commission considered the 2020 Adopting release and the 2019 Adopting Release. See CII Letter, Deloitte Letter, PwC Letter, and Consumer Federation of America, et al. Letter.

²⁴ See PCAOB Adopting Release at 27.

the PCAOB staff published a white paper that provides general information about characteristics of EGCs (“EGC White Paper”).²⁵ In the EGC White Paper, the PCAOB staff stated that “[a]pproximately 96% of EGC filers were audited by accounting firms that also audit issuers that are not EGC filers.”²⁶ Additionally, the PCAOB Adopting Release discussed the Commission’s intent to improve the practical application of Rule 2-01 of Regulation S-X and reduce compliance burdens, which may lead to increased competition among auditors and facilitate capital formation. The Board noted that if the Proposed Rules were determined not to apply to the audits of EGCs, auditors would be required to address the differing independence requirements in their independence policies and procedures and in their quality control systems as a result of the differences between the Board and Commission requirements, which would create the potential for confusion.²⁷

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 Commission’s amendments to Rule 2-01 were meant to more effectively focus the independence analysis on those relationships or services that are more likely to pose threats to an auditor’s objectivity and impartiality.

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

²⁵ See *Characteristics of Emerging Growth Companies and their Audit Firms as of November 15, 2019* (November 9, 2020), available at <https://archive.pcaobus.org/EconomicAndRiskAnalysis/ProjectsOther/Documents/White-Paper-Characteristics-Emerging-Growth-Companies-November-15-2019.pdf>.

²⁶ See EGC White Paper at 13.

²⁷ See PCAOB Adopting Release at 27.

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-2020-01) be and hereby are approved.

By the Commission.

Vanessa A. Countryman,

Secretary.