

31 July 2015

PCAOB  
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by email to: [comments@pcaobus.org](mailto:comments@pcaobus.org)

Dear Mr. Baumann,

**Re.: Staff Consultation Paper No. 2015-01:  
The Auditor's Use of the Work of Specialists – May 28, 2015**

The IDW would like to thank you for the opportunity to comment on the above mentioned Staff Consultation Paper: The Auditor's Use of the Work of Specialists, released May 28, 2015 (hereinafter referred to as the "paper").

The IDW agrees that there is a need to reconsider the appropriateness of the PCAOB's interim standards with regard to the auditor's use of the work of specialists because the need for expertise beyond auditing and accounting matters as well as the extent to which auditors rely on specialists has changed since those standards were developed. Alignment to the PCAOB's newer risk based standards is also needed, especially in the context of the audit of accounting estimates and fair value measurements.

As we have previously commented to the PCAOB, we welcome the updating of the PCAOB's interim standards, and particularly alignment with the relevant ISAs as a measure towards the international convergence of auditing standards needed for international capital markets. We refer to our previous letters to the PCAOB in which we addressed this issue more fully, as we have chosen not to

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repeat our detailed comments in this letter. We nevertheless confirm our previously stated views.

In this letter, we comment on those aspects of the paper with which we have concerns or upon which we hold firm views and have chosen not to respond to individual questions.

### ***The Potential Need for Standard Setting***

In addition to the issues discussed in the paper, the nature of action on the part of the PCAOB also ought to depend on the reasons behind any perceived lack of stringency within audits in this area. We note many instances where the paper explains that the Board has encountered non-compliance with the extant standard(s). In such cases, it would be useful for the Board to ascertain whether the underlying reason is a) a failure to satisfactorily document work that had actually been performed, b) an insufficient or erroneous understanding or interpretation of the requirements, or c) willful non-compliance on the part of the auditor. Enhanced clarification of the relevant requirements within the PCAOB's standards may be the most appropriate course of action in the first two cases. The deterrent impact of the Board's investigations program over time should already serve to address the last case.

Hence, although we support the Staff consultation as a means of gaining information as to current practice, we also believe that a thorough root cause analysis of the PCAOB's inspection findings is needed to inform the Board as to the possible need to enhance application guidance within its standards.

### ***Staff Consideration of Alternative Approaches***

#### *General Approach*

In terms of investor protection, action to prevent weaknesses occurring in the conduct of the audit is preferable to retrospective identification of weaknesses that have already occurred. Therefore, the IDW supports the Staff's view that the Board should focus on its standard setting activities rather than devoting additional resources to inspections and enforcement of existing standards. However, not all issues are susceptible to resolution through standards setting and therefore the PCAOB should ensure that standards setting activities are directed towards those issues that can be dealt with through standards.

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We comment on the alternatives discussed in the paper regarding the auditor's and company's specialists separately:

#### *Auditor's Specialist*

We support the development of a separate standard for using the work of an auditor's specialist "similar to the approach used by the IAASB in ISA 620" (alternative no. 1 on page 27). We particularly agree with Staff as to the benefits of a scalable approach that takes account of the practical differences resulting from the auditor's engagement as opposed to employment of a specialist.

In respect of the concern that this approach could "create the misconception that an auditor's employed specialist is not a member of the engagement team" (page 28), we note that the IAASB includes a definition of the term "auditor's expert" that specifically clarifies this particular issue. We are not aware that this distinction has proven problematical in practice amongst auditors applying the ISAs and would encourage the PCAOB to expand the definition proposed on page 34 to specifically clarify this difference.

In our opinion, extending the supervision requirement in A-S 10 to an auditor's engaged specialist (alternative no. 2 on page 28) would likely be impracticable, since various factors, including access, may preclude an appropriate degree of supervision. Additional significant differences in this context include the fact that an engaged specialist may not be subject to the firm's training and quality control system. Furthermore, as we discuss in more detail below, a proposal similar to that explored on page 28 i.e., to "integrate the engaged specialists into the engagement team" would potentially decrease the availability of specialists in some fields or jurisdictions to the detriment of audit quality.

#### *Company's Specialist*

Of the two alternatives discussed in the paper, we would have a slight preference for the Board rescinding AU sec 336 as far as it relates to company specialists. In our view, the concern highlighted in the paper that this would result in less specific direction for auditors could be relatively easily overcome by guidance pointing auditors to the relevant PCAOB standards.

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***Key Aspects of a Potential New Standard and Related Potential Requirements***

In general, we are concerned that some potential requirements discussed in the paper include requirements in relation to procedures that mirror application material as opposed to requirements of the ISAs. Such procedures may be appropriate in certain circumstances; they may however be excessive in some other circumstances. Thus explanatory material as to how the auditor may fulfil requirements that are applicable in all cases would be appropriate. For example, ISA 620.8 and A10 recognize that the nature, timing and extent of the auditor's procedures with respect to specific procedures will depend on a variety of matters. To the extent that the PCAOB deems further requirements beyond those of ISA 620 necessary in the context of SEC issuers, they should either be conditional requirements or be applicable only to specific circumstances.

We also suggest that the material in ISA 620.A5, which points out the potential reduction in risk assessment when the company uses a specialist, in combination with internal controls in this regard should also be reflected in the PCAOB's approach.

Bearing this position in mind, we would like to make the following comments regarding auditor's and company's specialists separately:

*Auditor's Specialist*

We agree that any revisions to the PCAOB's standards should require the auditor to a) evaluate the knowledge, skill and objectivity of an auditor's specialist; b) inform the specialist of his or her responsibilities; and c) evaluate the specialist's work and conclusions (pages 28 and 35). However, ultimately the auditor will need to scale his or her own work as necessary using his or her professional judgement having assessed a number of factors (see ISA 620.08). We comment on the three aforementioned aspects in turn:

a) Evaluation of the knowledge, skill and objectivity of an auditor's specialist

Clearly the manner in which the auditor can evaluate whether the specialist has the prerequisite levels of knowledge, skill and objectivity will depend on the specialist's status vis-à-vis the firm (employed or engaged). In general, employed specialists are likely more prevalent in larger audit firms, whereas engaged specialists are likely more commonly used by smaller firms. For example, a term similar to that used in ISA 620 (necessary competence, capabilities and objectivity for the auditor's purpose) is appropriate, since it acknowledges the relevance of these attributes to the specific circumstances.

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Some aspects of the potential requirement in the box on page 36 may be excessive and impracticable. A requirement to evaluate the specialist's "reputation and standing in the views of peers and others familiar with the capability or performance of the auditor's specialist" (item c.) could be excessive when the auditor is already satisfied as to the professional qualifications and experience of the specialist. In any case, it may be impossible to fulfil, if there are few such specialists in a jurisdiction or if there is reluctance in the area of specialty to "grade" competitors. Thus this evaluation should not be required in every case.

We comment on the issue of objectivity, and specifically on the two alternatives upon which views are sought in a separate section of this letter.

b) Informing the specialist of his or her responsibilities (pages 37 and 38)

We are concerned as to the practical connotations of a requirement for "reaching agreement regarding ... the importance of professional skepticism in an audit and the need to consider contradictory information". The auditor cannot delegate the exercise of professional skepticism to the specialist, nor will the specialist likely have the required training to fully appreciate what this means and entails in practice. The instructions need to be very clear on these aspects and may need to be rephrased as to require the specialist to inform the auditor of all information that is contradictory to, or deviates (by a specific amount determined by the auditor), from the specialist's findings or conclusions.

We also believe that an agreement also needs to recognize that the auditor may have encountered additional information in this context during the audit to which the specialist is not privy, and that the auditor may pass this on to the specialist in a timely manner to the extent permitted under confidentiality requirements. Matters such as adherence to confidentiality requirements or, where applicable, the need to notify the auditor of changes in circumstances pertaining to the specialists' objectivity should also be reflected in specific agreements with the auditor's specialist.

c) Evaluation of the specialist's work and conclusions

In our view, the potential requirements for evaluating the work of an auditor's specialist as depicted in the boxes on pages 40 - 41 are generally reasonable but there is a need for the PCAOB to explain the possible manner(s) in which the auditor may fulfil these requirements.

We note the observation on page 41 that the auditor's understanding of the specialist's subject matter may vary depending on the particular area of expertise. ISA 620 contains useful guidance material as to how an auditor may

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obtain an understanding of the field of expertise sufficient to enable the auditor to determine the nature, scope and objectives of the work to be performed by the expert and to evaluate the adequacy of that work for the auditor's purposes (as required by ISA 620.10). Because it is the sufficiency of this understanding that may be the key issue in practice, we believe that it would be appropriate for the PCAOB to include similar guidance.

We agree that professional skepticism is a key issue and that it is appropriate for the PCAOB to address issues related to the failure of the auditor to consider contradictory evidence or to resolve discrepancies, differences or other concerns that the specialist identified.

#### *Company's Specialist*

We concur with Staff's view that the objectivity and competence of the specialist in combination with other factors in the auditor's risk assessment should be key factors in the auditor's consideration of the extent to which he or she may use that work, if at all, and generally support the Staff's deliberations in the second paragraph of section D on page 30. This broadly mirrors the approach taken in ISA 500.

The auditor's decision to employ or engage an auditor's specialist needs to be dependent on various factors, including the auditor's own knowledge and experience of the area of specialization, and needs to follow a risk based approach. The IDW therefore believes a principles-based approach similar to that of ISA 500 is needed.

Whilst we understand the concerns raised on pages 30 and 31 in relation to extant text concerning the role of the specialist and the auditor's acceptance of specialists' work, we are concerned that the Staff proposal to revise the extant wording of AU sec 336 – and, in particular, the elimination of text that currently permits the auditor to use the specialist's work without further examination – may have unintended consequences. For example, the elimination of text could be interpreted as a de facto preclusion of using a company's specialist in all cases; whereas a change in the wording to acknowledge this as a possibility in cases not involving significant risks, or involves low risks of material misstatements, and where the auditor exercises professional skepticism and does not have indications that contradict the specialist's work might be a better alternative.

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### ***Additional Specific Issues***

#### *Delineation between Auditor and Specialist*

The delineation between auditing and accounting and other areas of expertise is generally clear to those in the auditing profession. We agree that the potential definition of the term “Specialist” benefits from the proposed clarification in foot note 2, but suggest the following wording: “Because income provisions and information technology used in accounting systems are specialized areas of accounting and auditing, this definition does not apply to a person with specialized knowledge or skill in those areas.” However it might also be helpful to expand on this to explain that e.g., an individual who specializes in complex taxation law would be providing legal expertise and so would constitute a legal specialist, or that an expert in IT beyond the basic accounting system would be an IT specialist. In this context we refer to ISA 620.A2.

#### *Objectivity of an Auditor’s Specialist*

During its so-called clarity project, the IAASB debated at some length whether an auditor’s engaged specialist should be considered as a member of the engagement team and thus be required to adhere to the audit firm’s independence rules. This proposal was, however, rejected by the IAASB on the grounds that such a requirement could deny the auditor access to appropriate specialists. Therefore, we do not believe that alternative no 1 (i.e., to apply the requirements of Rule 2-01 of Regulation S-X to engaged auditor’s specialists) would be in the interests of investors.

In some jurisdictions and in some fields of expertise, there may be a limited number of specialists and so the balance between inconsequential threats to independence and that specialist’s professionalism which may mitigate any perceived threat needs to be weighed against the desire to permit the auditor recourse to the best possible expertise.

We therefore believe that the Board should adopt a principles-based “enhanced objectivity approach” along the lines described in the paper. However, we note that the potential requirements set forth in the paper are far more prescriptive than the requirements of ISA 620, and in many cases mirror the application material in that standard. To the extent that the PCAOB intends to follow its risk based approach these are potentially excessive. For example, if the auditor obtains detailed information from the company as to the threats to objectivity of the auditor’s engaged specialist it seems excessive to require the specialist to



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duplicate this in “a written description regarding (i) any business, employment or financial relationships .... and the process used by the specialist to formulate the responses to (i)”. The PCAOB does not set requirements for external specialists and requiring the auditor to enforce such requirements in his or her negotiations pertaining to the engagement of a suitably qualified specialist could have the similar impact as described above in regard to requiring specialists adhere to stringent independence rules. In our view, it may be equally appropriate to consider whether the objective of ensuring objectivity could be fulfilled by alternative means, e.g. explicit confirmation in an engagement letter as well as obtaining a letter of representation from the specialist.

If you have any further questions about our comments, we would be pleased to discuss our comments with you.

Yours very truly,

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