



August 30, 2017

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, DC 20006-2803

RE: PCAOB Rulemaking Docket Matter No. 044

Dear Madam Secretary:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's ("PCAOB" or "Board") Proposed Amendments to Auditing Standards for Auditor's Use of the Work of Specialists (the "proposed amendments") in PCAOB Release No. 2017-003 (the "release"). We commend the Board and its staff for its work to build on the feedback received on its May 2015 Staff Consultation Paper ("the staff consultation paper") and move forward with a standard-setting proposal.

Overview

We are supportive of the overall project and agree auditing standards could be enhanced related to the auditor's use of the work of specialists. We generally believe the staff consultation paper and the release appropriately characterize current practice and the ways in which auditors use the work of specialists. Our observations and recommendations in this letter are informed by the evolution of our firm's use of specialists in our audits. As highlighted in our response to the staff consultation paper, as it relates to an auditor's specialist, our engagement teams primarily use specialists employed by our firm. These employed specialists are subject to our independence requirements and our firm's quality controls. Our engagement teams may use an auditor-employed specialist to either test the process used by management to develop the estimate and/or develop an independent estimate. Our engagement teams may also engage a third-party specialist in certain circumstances. An engagement team's determination of the appropriate use of a specialist is driven by its risk assessment process and the engagement team's professional judgment regarding the most effective manner of obtaining sufficient appropriate audit evidence.

As a result, we are supportive of the proposed risk-based approach to the supervision of the work of these specialists, particularly in relation to auditor-employed and auditor-engaged specialists. In many respects, our current methodology aligns with the proposed amendments, and we do not expect that significant incremental efforts would be necessary to adopt the proposed amendments.

We also agree that the auditor's responsibilities in relation to the work of a company's specialist should be explicitly addressed in the standards and are supportive of the PCAOB's development of proposed Appendix B to AS 1105, *Audit Evidence*, to do so.

It is important the PCAOB continues to make clear in its standards that the auditor is not expected to have the expertise of a person trained for or qualified to engage in the practice of another profession or occupation and to address the auditor's responsibilities in such circumstances to evaluate the specialist's conclusions. We also observe that it would not benefit audit quality if the proposal was viewed as dissuading auditors or companies from using specialists.



In this letter, we have included certain suggestions regarding some of the specific requirements described in, or implied by, the proposed amendments to address what we see as potential practical challenges, not only in the audit process but in the overall financial reporting process. We have organized our observations and recommendations into the following topical areas:

- Amendments to AS 1105 to address using the work of a company-engaged specialist
- Amendments to AS 1210, *Using the Work of an Auditor-Engaged Specialist*
- Amendments to AS 1201, *Supervision of the Audit Engagement*, to address supervision of the work of auditor-employed specialists
- Proposal to rescind AI 11, *Using the Work of a Specialist: Auditing Interpretations of AS 1210*
- Other matters

I. Amendments to AS 1105 to address using the work of a company-engaged specialist

Testing and evaluating the work of a company-engaged specialist

We agree with the Board's observation that the auditor's consideration of significant assumptions and methods used by the company's specialist may be more challenging compared to equivalent procedures performed by the auditor when using an auditor's specialist with whom the auditor has an employment or contractual relationship.¹

We are supportive of the proposed language used in paragraphs .B6 and .B8 of the proposed Appendix B to AS 1105 related to evaluating the relevance and reliability of a company specialist's work and its relationship to the relevant assertion. The PCAOB has noted its intent in paragraph .B7 was to establish a risk-based approach to determining the extent of evidence that is necessary from the auditor's testing and evaluation of the specialist's work. However, as we expressed in our response to the staff consultation paper, we are concerned that if the auditor is not able to evaluate the work of a company's specialist in the manner contemplated in proposed Appendix B to AS 1105, the auditor's ability to test the process used by management to develop an accounting estimate when management engages a specialist may be limited in certain circumstances. Specifically, we believe further clarity is needed in relation to the note that follows paragraph .B8 that references complying with the requirements in paragraphs .09–.18 of Proposed Auditing Standard AS 2501, *Auditing Accounting Estimates, Including Fair Value Measurements*. In our view, the reference to AS 2501 appears likely to hinder or restrict the auditor's ability to use a risk-based approach and could be viewed as being contrary to the intent of paragraph .B7.

We also believe the way the requirements on using the work of a company specialist (whether employed or engaged) in relation to accounting estimates are structured would result in a significant change in practice from current AS 1210, *Using the Work of a Specialist*. AS 1210 focuses on obtaining an understanding of the methods and assumptions used by the specialist and making appropriate tests of data provided to the specialist. Without further clarification, we believe the proposed audit approach would not recognize the practical challenges that arise when an estimate is developed by a company-engaged specialist. For example, it may not be possible for the auditor to evaluate the method used to develop an accounting estimate when a company-engaged specialist is used to the same extent as when a company-employed specialist is utilized, in particular if the specialist uses a proprietary model to which the auditor does not have access. While footnote 2 of AS 2502 essentially requires auditors to evaluate the reasonableness of assumptions developed by the company's specialists (whether employed or engaged) as if they were

¹ See page 36 of the release.



developed by management for fair value measurements, we are concerned about the implications of extending this concept to significant assumptions for all estimates in significant accounts and disclosures (i.e., whether it will be possible for auditors to comply with the requirements in paragraphs .15-.18 of proposed AS 2501).

Nevertheless, we believe the extent to which the auditor could use the work of the specialist as audit evidence should depend upon the extent to which the auditor is satisfied the work of the specialist is relevant and reliable as well as the assessed risks of material misstatement. The requirement in paragraph .B2 clarifies the auditor's responsibility to understand the company's processes and controls regarding the work of the company's specialists. Controls over the use of company-engaged specialists, including how the company evaluates the specialist's work, can be important for the auditor to consider when evaluating the work of a company-engaged specialist that uses a proprietary model (including data and assumptions).

Assessing the specialist's relationship to the company

We believe that a focus on the objectivity of a specialist, whether engaged or employed by the company, continues to be appropriate, with the understanding that objectivity is viewed on a spectrum, taking into account threats to objectivity. We believe the concept of objectivity is addressed in the requirement to assess the specialist's relationship to the company. Accordingly, we support the proposed requirement in paragraph .B4 of AS 1105 for the auditor to assess the specialist's relationship to the company.

The proposed requirement would also extend the auditor's assessment to include the relationship between the company and the entity that employs the specialist, if the specialist is not employed by the company. We agree with the PCAOB's view that a strong reputation and standing of the specialist's employer in the specialized field can be a signal that the employer maintains qualified staff. However, we believe there will be practical challenges in requiring the auditor to make an assessment of the entity that employs the specialist. In our view, the release does not adequately consider the limitations and cost and other implications of this proposed requirement.

We appreciate that paragraph B5 of AS 1105 indicates that the nature and extent of evidence necessary to assess the knowledge, skill, and ability of the company's specialist and the specialist's relationship to the company may vary. It is unlikely that many entities that employ specialists will have existing policies, procedures, and systems to track all of the entity's relationships with individual companies to which it provides services in a manner that would support the new expectations intended by the proposal (e.g., maintaining robust documentation of employment, financial, ownership, or other business relationships, contractual rights, family relationships). Furthermore, since the auditor does not hire, direct, or oversee a company's specialist, it is unclear how an auditor would be in a position to assess such policies, procedures, and systems that do exist. While we agree the potential sources of information suggested on page A3-13 of the release may provide relevant evidence, in practice, the auditor's evidence will be primarily based on inquiry of the specialist, as the auditor will not have access to all of the relevant information from the entity employing the specialist. The auditor may also obtain representations from the company using the specialists about any relationships it may have with the entity employing the specialists.

We believe the PCAOB should perform additional outreach to understand and assess whether and, if so, how entities of varying sizes and disciplines that employ a range of specialists track the entity's relationships with its clients. In particular, we think there is a need for the PCAOB to consider an economic analysis of the costs to entities employing specialists, companies, and auditors and to gather



more evidence to evaluate whether the benefit to audit quality justifies such costs to determine whether this is an issue the PCAOB needs to address in this manner. Additionally, absent new guidance setting out expectations for management from the SEC, requiring auditors to obtain such information from an entity employing a company-engaged specialist could be viewed as establishing requirements through auditing standards in relation to a company's responsibilities for maintaining books and records and systems of internal accounting controls.

In addition, the release notes the requirement in paragraph .B2 for the auditor to understand the company's processes and controls, including the company's process for selecting and using the work of specialists, should prompt auditors to appropriately consider the interaction of the specialist's work and the company's processes in assessing and responding to risk in the related accounts and disclosures.² We agree the company should have a reasonable basis for selecting from qualified specialists, but it would be useful for the PCAOB to provide greater specificity about the nature and intent of the requirement to understand the company's process for selecting and using the work of specialists.

II. Amendments to AS 1201, *Using the Work of an Auditor-Engaged Specialist*

We support the proposed clarification of the expectations of auditors when engaging a specialist, although we primarily use auditor-employed specialists. As noted in paragraph .02, 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. We appreciate the PCAOB's clarification that the proposal does not require the auditor to have full access to a specialist's proprietary model or to reperform the work of a specialist, but instead to evaluate the work of that specialist in accordance with the proposed standard.³ We believe similar clarification would be warranted in relation to a company-engaged specialist.

Evaluating the objectivity of the auditor-engaged specialist and the entity that employs the specialist

We agree with the proposal for the auditor to consider the auditor-engaged specialist's relationship to the company. We support a focus on whether an auditor-engaged specialist has the necessary objectivity to exercise impartial judgment on all issues encompassed by the specialist's work related to the audit. Paragraph .05 of proposed AS 1210 prohibits the use of a specialist who lacks the necessary objectivity. Consistent with current standards, we believe the auditor should not be precluded from using the work of a specialist who has relationships with the client in addition to the contractual agreement to perform the specific work the auditor intends to use. We believe the auditor should evaluate any relationships and ultimately make a decision on the significance and implications of the threats to objectivity. In our view, objectivity is a spectrum, and the auditor could potentially put safeguards in place to take into account threats to objectivity, including performing additional procedures on the work of the specialist.

Similar to a company-engaged specialist, we have concerns as to the practicality of the requirement for auditors to evaluate whether the entity that employs the auditor-engaged specialist is objective, including whether the entity has a relationship with the company or any other conflicts of interests relevant to the work performed. While we agree the potential sources of information suggested on page A3-40 of the release may provide relevant evidence, in practice, the auditor's evidence will be primarily based on

² See page A3-9 of the release.

³ See page A3-43 of the release.



inquiry of the auditor's engaged specialist (the response to which will by its nature potentially be incomplete due to limitations regarding existence of and access to policies, procedures and systems), as the auditor may not have access to all of the relevant information from the entity employing the specialist. We therefore recommend reconsidering the requirement to assess the objectivity of the entity that employs the specialist. As an alternative, the PCAOB could consider adding a note to follow paragraph .04 as follows:

Note: In considering the objectivity of the specialist, the auditor should inquire of the specialist as to whether the specialist is aware of any relationships between the entity that employs the specialist and the company.

If the PCAOB decides to retain this requirement, additional guidance about what such an assessment might entail would be necessary. We do not believe it is appropriate for the proposed standard to establish requirements that would necessitate a determination of whether the entity employing the specialist has appropriate policies, procedures, or systems in place to identify potential relationships, including with respect to financial relationships.

Additional suggestion

We support the manner in which the proposed standard articulates areas of focus in developing a mutual understanding between the auditor and an auditor-engaged specialists about the specialist's work. It might be useful to consider whether the communication with the specialist should also include matters the specialist should communicate to the auditor and set expectations regarding the nature, timing, and extent of communications between the auditor and the specialist. This comment is equally applicable to using an auditor-employed specialists.

III. Amendments to AS 1201, *Supervision of the Audit Engagement*, to address supervision of the work of auditor-employed specialists

We support the proposed amendments to AS 1201, *Supervision of the Audit Engagement*, as the proposed requirements could enhance consistency in execution. We believe proposed Appendix C largely reflects our current approach to specialists employed by our firm. We appreciate the clarification in the release that the auditor would be able to use information from the firm's quality control system in assessing the knowledge, skill, ability, and independence of auditor-employed specialists.⁴

IV. Proposal to rescind AI 11, *Using the Work of a Specialist: Auditing Interpretations of AS 1210*

Our response to the staff consultation paper recommended the Board not rescind AI 11, as that interpretation currently serves as the sole source of authoritative guidance to assist auditors in evaluating the sufficiency of legal opinions obtained to support the assertion that transferred financial assets meet the legal isolation criterion in ASC 860, *Transfers and Servicing*.

The release states that AI 11 reflects outdated accounting requirements and banking regulations. Although AI 11 would require updating to reflect the release of Accounting Standards Update (ASU) 2009-16, *Transfers and Servicing (Topic 860): Accounting for Transfers of Financial Assets*, the ASU did not

⁴ See page A3-28 of the release.



fundamentally change the de-recognition model in Financial Accounting Standards No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, (including the legal isolation assertion) that has been in effect since 2001. Insured depository institutions that have sold financial assets that they intend to de-recognize must continue to obtain legal opinions to support the legal isolation assertion (certain amendments to the Federal Deposit Insurance Corporation’s “safe harbor rule” in 2010 notwithstanding). AI 11 provides tailored guidance to assist auditors in evaluating the sufficiency of legal opinions as audit evidence. As an example, the interpretation requires that the opinions be expressed at a “would level,” identifying certain qualifications that may call into question whether the legal analysis adequately demonstrates that the assets transferred meet the isolation assertion, and clarifying under what circumstances a substantive consolidation opinion should be obtained for entities subject to the US Bankruptcy Code. Finally, the “auditor reliance” language that appears in paragraph .18 of AI 11 addresses that an auditor can rely on counsel’s opinion for the purpose of evaluating management’s assertion, despite the absence of contractual privity between the two. We continue to believe that the PCAOB should update and retain the interpretation.

V. Other matters

Potential costs to auditors and companies

A number of our comments highlight practical considerations, which are likely to have an impact on costs. While difficult to quantify, costs are likely to increase as a result of the proposals, in particular for smaller firms that do not typically use auditor-employed specialists as frequently. Increases in costs are also likely in areas where highly specialized skills or knowledge are needed, especially if the changes to the requirements to evaluate the work of a company-engaged specialist would result in auditors more frequently determining it is necessary to use an auditor-engaged specialists to evaluate that work. This could result in strain on limited specialist resources in particular industries, or less qualified specialists being used if the view taken towards “the relationship of the company to the entity employing the specialists” is overly prescriptive. We believe there is a need for the PCAOB to gather more evidence about the implications of these practical considerations and their potential costs.

Restrictions, disclaimers, and limitations included in specialist’s reports

We support the proposed requirement in paragraph .B9 of AS 1105 to evaluate the relevance and reliability of the specialist’s work and whether the specialist’s findings support or contradict the relevant assertion. We agree that a specialist’s report may contain restrictions, disclaimers, or limitations that could cast doubt about the relevance and reliability of the information contained in the specialist’s report, but that other restrictions, disclaimers, or limitations may not affect the auditor’s ability to use the specialist’s work as audit evidence.⁵ We believe that the discussions of restrictions, disclaimers, and limitations on page A3-23 of the release are equally applicable to situations involving auditor-engaged specialists, and thus we suggest providing clarity that these same factors may be used by auditors in assessing restrictions, disclaimers, and limitation in reports from auditor-engaged specialists.

Applicability of the proposed standard

We believe the PCAOB should develop its performance standards in a way that can be scaled and tailored to any audit. Having separate performance standards for audits of emerging growth companies or audits

⁵ See page A3-23 of the release.



of brokers and dealers would be confusing and unhelpful to promoting consistency in audit quality. Accordingly, we support the PCAOB's position that the proposed amendments would apply to audits of emerging growth companies and audits of brokers and dealers and have not identified any additional areas of concern unique to those audits.

Effective date

The PCAOB has suggested an effective date for audits for fiscal years beginning in the year after approval by the SEC (or for audits of fiscal years beginning two years after the year of SEC approval if that approval occurs in the fourth quarter). The reasonableness of this timeframe is dependent upon how the PCAOB considers and responds to the observations and suggestions from commenters and the extent to which the final standard is consistent with current practice.

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We appreciate the opportunity to express our views and would be pleased to discuss our comments or answer any questions that the PCAOB staff or the Board may have. Please contact Leonard Combs (973-236-5265) regarding our submission.

Sincerely,

A handwritten signature in black ink that reads "PricewaterhouseCoopers LLP". The signature is written in a cursive, flowing style.

PricewaterhouseCoopers LLP