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July 31, 2015

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

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

Dear Office of the Secretary:

The Center for Audit Quality (CAQ) is an autonomous public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. The CAQ fosters high quality performance by public company auditors, convenes and collaborates with other stakeholders to advance the discussion of critical issues requiring action and intervention, and advocates policies and standards that promote public company auditors' objectivity, effectiveness, and responsiveness to dynamic market conditions. Based in Washington, D.C., the CAQ is affiliated with the American Institute of Certified Public Accountants.

The CAQ welcomes the opportunity to comment on the staff of the Office of the Chief Auditor (the Staff) of the Public Company Accounting Oversight Board's (PCAOB or the Board) *Staff Consultation Paper 2015-01 – The Auditor's Use of the Work of Specialists* (the Consultation Paper). This letter represents the observations of the CAQ, but not necessarily the views of any specific firm, individual, or CAQ Governing Board member.

The CAQ concurs with the Staff's observations in the Consultation Paper that the use and importance of specialists have increased in recent years, in part due to the increasing complexity of business transactions and the information needed to account for those transactions.¹ We commend the Staff for acknowledging that careful deliberation and extensive outreach to key stakeholders² is needed in considering enhancements to existing auditing requirements and guidance, including consideration of the views expressed in response to the Staff's previous consultation paper titled *Auditing Accounting Estimates and Fair Value Measurements*. We believe any enhancements to existing auditing standards and guidance should promote audit quality, be operational and adaptable to changes in the evolving capital markets, and continue to recognize that auditors will likely need to use the work of a specialist when audit matters require specialized knowledge and subject matter expertise in a field other than accounting or auditing. We continue to believe that both this project and the project on Auditing Accounting Estimates and Fair Value Measurements are closely linked and any enhancements to the related standards should be considered in concert.

¹ Page 3, the Consultation Paper.

² For instance, the PCAOB discussed the auditor's use of the work of specialists at its Standing Advisory Group meeting on June 18, 2015.

In this letter, we offer for the Board's and Staff's consideration our views regarding certain topics outlined in the Consultation Paper, including the Staff's suggested amendments to the related auditing standards (the potential amendments or potential requirements). Our views are organized into the following sections:

- I. General Views on the Staff's Consultation Paper
 - a. Importance of Retaining the Principles of AU336
- II. Using the Work of an Auditor's Specialist
 - a. Extending the Auditor's Supervision Requirements
 - b. Evaluating the Knowledge and Skill of an Auditor's Specialist
 - c. Informing an Auditor's Specialist of His or Her Responsibilities
 - d. Evaluating the Work of an Auditor's Specialist
 - e. Evaluating the Objectivity of an Auditor's Specialist
- III. Using the Work of a Company's Specialist
 - a. Evaluating the Objectivity of a Company's Specialist

I. General Views on the Staff's Consultation Paper

The Consultation Paper discusses certain operational challenges related to the auditor's use of the work of specialists, and presents potential amendments to PCAOB auditing standards that govern the auditor's use of the work of specialists. These potential amendments could affect certain aspects, or potentially rescind all, of AU sec. 336, *Using the Work of a Specialist* (AU336), and could affect certain aspects of Auditing Standard No. 10, *Supervision of the Audit Engagement* (AS10). We support the Staff's consideration of amendments to existing auditing standards, and believe any such amendments related to the auditor's use of the work of specialists should, at a minimum: i) align with the Board's risk assessment standards, ii) include an evaluation of the impact of the potential enhancements on the existing standards related to accounting estimates, including fair value measurements, and iii) generally retain the principles in AU336, as discussed further below.

The CAQ supports the potential definitions of *specialist*, *auditor's specialist* and *company's specialist* that are included in the Consultation Paper.³ With respect to the definition of a specialist, we support the continued recognition of income tax and information technology as specialized areas of accounting and auditing, and the exclusion of those persons from the definition.

The CAQ believes that enhancements to the existing auditing standards should be principles-based and recognize the relationship between the auditor's risk assessment and the audit procedures designed to sufficiently and appropriately respond to those risks. Any enhancements should allow for auditors of issuers of different complexities and compositions to apply the auditing standards consistently, without limitations or restrictions.

We have focused our suggestions below on auditing matters, but believe that many of the potential amendments could have a significant effect on issuers and specialists. Therefore, we believe a holistic approach that examines opportunities for improvement in the roles and responsibilities of all members of the financial reporting supply chain with respect to use of specialists, including obtaining additional feedback from specialists, would best meet the needs of investors and other stakeholders.

a. Importance of Retaining the Principles of AU336

The Consultation Paper identifies observations from Board oversight activities that the Staff believes indicate a potential need for change to the auditing standards.⁴ We support the consideration of potential changes, and believe such changes would be better accomplished through enhancing, as opposed to rescinding, AU336. The CAQ believes that AU336, when applied properly, places an appropriate amount of responsibility on the auditor to evaluate the work of a specialist. In particular, we believe any potential amendments should retain the core

³ Page 34, the Consultation Paper.

⁴ Page 23, the Consultation Paper.

principle of AU336: 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 based on auditor judgment, may encounter matters that require such specialized skill.⁵ The auditor's ability to utilize the framework in AU336 in arriving at this judgment should be maintained and ultimately strengthened by certain clarifying enhancements, which are discussed in detail below.

As we expressed in our comment letter on the Staff's previous consultation paper titled *Auditing Accounting Estimates and Fair Value Measurements*, of particular concern with the suggested amendment to rescind AU336⁶ is that a potential new requirement to evaluate information provided by a company's specialist in the same manner as information produced by others in the company would be required for all accounting estimates. The Staff acknowledges that this potential new requirement would likely result in additional testing by the auditor.⁷ Paragraph 12 of AU336 supports the core principle that the auditor is not expected to have the expertise of another profession and states that "the appropriateness and reasonableness of the methods and assumptions used and their application are the responsibility of the specialist." We are concerned that this additional testing effort, when coupled with the potential consequences of the suggested requirements in the Consultation Paper regarding the evaluation of an engaged specialist's objectivity,⁸ could be significant, especially in situations where the auditor may not possess the required knowledge or skills related to certain audit matters and may need to engage a specialist.

II. Using the Work of an Auditor's Specialist

a. Extending the Auditor's Supervision Requirements

The auditor's determination of whether to use the work of a specialist in the audit is driven by the auditor's risk assessment process, which includes considering the complexity of the estimate or fair value measurement, its significance to the audit, and the knowledge, skill, and ability of the engagement team members.

When a specialist is employed by an accounting firm, we believe the specialist should continue to be considered a member of the engagement team and be subject to the same supervision and review requirements as any other engagement team member in accordance with AS10. However, the potential amendment to extend the supervision requirements of AS10⁹ (which would include ensuring compliance with all PCAOB standards, including the Quality Control and Ethics and Independence standards) to an engaged specialist could be difficult to apply and, in some cases, compliance by the engagement partner may not be possible given that engaged specialists are not a part of the accounting firm's training, resource monitoring, or overall system of quality control.

b. Evaluating the Knowledge and Skill of an Auditor's Specialist

An auditor's employed specialist is subject to the firm's overall system of quality control which, under Quality Control Section 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice* (QC20), includes evaluation of an employee's independence, integrity and objectivity, personnel management, engagement performance, and monitoring, among other things. This system of quality control is intended to provide a firm with reasonable assurance that employees are independent (in fact and in appearance) in all required circumstances, perform all professional responsibilities with integrity, and maintain objectivity in discharging professional responsibilities.¹⁰ QC20 provides engagement teams that use the work of an employed specialist with the appropriate basis to evaluate an employed specialist's knowledge, skills, and objectivity. As such, we believe that any enhancements to the auditing standards should continue to recognize the value and

⁵ Paragraph 6, AU336.

⁶ Page 32, the Consultation Paper.

⁷ Page 30, the Consultation Paper.

⁸ As discussed further below in Using the Work of an Auditor's Specialist section, the potential requirements relating to evaluating the objectivity of an engaged specialist could result in a diminished population of available specialists being able, or wanting, to provide services to audit firms.

⁹ Page 28, the Consultation Paper.

¹⁰ Paragraph 9, QC20.

importance of a firm's system of quality control in assessing the knowledge, skills, and objectivity of employed specialists.

In instances where the auditor uses the work of an engaged specialist, the auditor should continue to evaluate the specialist's knowledge and skill. Consistent with the requirements of International Standards on Auditing 620, *Using the Work of an Auditor's Expert* (ISA620), as well as many of the suggested amendments in the Consultation Paper, the auditor could continue to consider the following factors in evaluating the engaged specialist's knowledge and skill:

- Whether the engaged specialist's work is subject to technical performance standards or other professional or industry requirements;
- The engaged specialist's experience and reputation in the field in which the auditor is seeking evidence;
- The engaged specialist's knowledge of and experience in the entity's industry;
- The relevance of the engaged specialist's competence to the matter for which the specialist's work will be used, including any areas of specialty within the specialist's field;¹¹ and
- The specialist's competence with respect to relevant accounting and auditing requirements.

In addition, we question the language in the Consultation Paper that states "for an employed specialist, the auditor may take into account information available from the accounting firm (e.g., information contained in the firm's QC system, results of internal and external inspections, and results of the firm's performance reviews) to assist him or her in [evaluating the specialist's knowledge and skill]."¹² When using the language "take into account," it is unclear whether the Staff is considering changing current practice by having each engagement team obtain the relevant information, or the engagement team could, for example, rely on input from the firm's specialist group and the firm's QC systems to make this determination. Consistent with International Standards on Auditing 220, *Quality Control for an Audit of Financial Statements*, we believe that unless information provided by the accounting firm or other parties suggest otherwise, the engagement team should be able to rely on the firm's system of quality control in evaluating the competence of its personnel. In addition, we believe that engagement teams must also ensure that an evaluation of the competence, capabilities, and objectivity necessary for the purposes of the audit, are met.¹³

c. Informing an Auditor's Specialist of His or Her Responsibilities

We support the potential requirement within the Consultation Paper for the auditor to reach an agreement with the auditor's specialist on certain matters that are the responsibility of the specialist "in writing."¹⁴ The Staff's language within the Consultation Paper, which does not appear to be included in a potential requirement, suggests that "evidence of the agreement between the auditor and the auditor's specialist might be in the planning memorandum, separate memorandum, audit programs, or other related workpapers."¹⁵ We believe this footnote provides an appropriate amount of flexibility to the auditor and should be explicitly stated within a potential requirement.

d. Evaluating the Work of an Auditor's Specialist

We continue to believe that AU336 provides the auditor with the appropriate framework to evaluate the work of an auditor's specialist, whether employed or engaged, and we are concerned with the potential requirement within the Consultation Paper to evaluate the work of an auditor's specialist differently (i.e., "determine whether"¹⁶ versus "evaluate the conclusions"¹⁷) depending on whether the specialist (i) develops an independent

¹¹ For example, a particular actuary may specialize in property and casualty insurance, but have limited expertise regarding pension calculations.

¹² Page 36, the Consultation Paper.

¹³ Paragraph 9, ISA620.

¹⁴ Page 37, the Consultation Paper.

¹⁵ Page 38, footnote 74, the Consultation Paper.

¹⁶ As outlined in item a. on Page 40, the Consultation Paper.

¹⁷ As outlined in item b. on Page 40, the Consultation Paper.

estimate or (ii) tests the methods and significant assumptions used by the company. This potential amendment could be interpreted as requiring the auditor to re-perform the work of the auditor's specialist by developing an independent conclusion on the audit matter when the auditor's specialist develops an independent estimate. However, if the auditor has concluded that a specialist is competent, objective, and has an understanding of his or her responsibilities, the auditor should be able to rely on the execution of the procedures and evaluate the reasonableness of the specialist's conclusions. By requiring a level of effort that goes beyond evaluating the specialist's conclusions, the alternative would mandate a level of expertise that auditors do not, and are not expected to, possess. We believe the requirements for the auditor in both situations should only include an evaluation of the specialist's conclusions about the items outlined in the potential amendments.

Currently, when the auditor believes the findings are unreasonable, AU336 requires the auditor to apply additional procedures, which may include obtaining the opinion of another specialist, in order to use the work of the auditor's engaged specialist. We believe potential enhancements could adopt an approach similar to ISA620. Under that guidance, in situations where the auditor believes that the findings of the specialist are not adequate (e.g., because the findings are not consistent with other audit evidence), the auditor should agree with the specialist on the nature and extent of further work to be performed by the auditor's specialist, perform additional audit procedures appropriate to the circumstances, or engage another specialist to resolve the matter.

e. Evaluating the Objectivity of an Auditor's Specialist

The CAQ recognizes that evaluating the objectivity of an auditor's specialist is an integral part of determining the nature, timing, and extent of the specialist's procedures and the reliability of the specialist's work as audit evidence. For an employed specialist, as discussed above, we believe an audit firm's system of quality control provides the auditor with the appropriate basis to evaluate the objectivity of the specialist. However, we are concerned with potential limitations on the ability of an auditor to engage a specialist that could arise from the potential amendments regarding the evaluation of the objectivity of an auditor's engaged specialist, discussed in detail below. Further, we question why the Consultation Paper links whether a specialist is independent of the company to whether that specialist is capable of exercising objective and impartial judgment in his or her work. Rather than indirectly imposing specific independence requirements on specialists, we believe the existing requirements in AU336 could be enhanced to provide additional specificity around how the auditor evaluates the objectivity of an auditor's engaged specialist, as well as how that evaluation would affect the auditor's assessment of the reliability of the evidence obtained from the specialist, as further discussed in detail below within our suggestion in the Enhanced Objectivity Approach.

Rule 2-01

The Consultation Paper outlines a potential amendment that would require an auditor-engaged specialist to comply with the requirements of Rule 2-01 of Regulation S-X adopted by the SEC (Rule 2-01). As discussed further below, we believe that there are significant unintended consequences to this alternative, including the potential that engaged specialists would be unable or unwilling to comply with the level of quality control processes and procedures necessary for the monitoring and evaluation of relationships that might impair that specialist's independence. Such changes could result in certain specialists no longer being able, or wanting, to provide certain services to audit firms, which could diminish the population of available specialists. Accordingly, accounting firms that do not have employed specialists on staff may determine that they are unable to engage specialists necessary to their audits that enable them to comply with these requirements, which would limit their ability to continue to audit public companies.

As acknowledged in the Consultation Paper, Rule 2-01 was written primarily for accounting firms and not for other organizations, such as specialist entities, that are not structured similarly, and specialist entities and individual specialists may have considerable challenges in complying with this rule.¹⁸ We question whether

¹⁸ Page 47, the Consultation Paper.

the potential requirements could be effectively monitored and enforced for entities and individuals that are otherwise not subject to the SEC's independence rules.

Enhanced Objectivity Approach

Under this alternative, we support the potential amendment for the auditor to identify certain business, financial, and employment relationships that might impair an engaged specialist's objectivity.¹⁹ However, we do not believe that the auditor should be required to "obtain information about the process used by the auditor's engaged specialist to formulate responses to the auditor's request for information."²⁰ The processes and procedures that a specialist's firm has in place to maintain independence and objectivity, including how information related to potential independence conflicts is obtained and compiled, could vary greatly in practice. Further, the approach used by accounting firms seeking to obtain information about the specialist firm's processes and procedures could also vary greatly in practice. Alternatively, we believe the requirements for the auditor to obtain information as to the specialist's relationships with the issuer should be similar to those provided for under ISA620,²¹ which require, for example, corroborating inquiries of the specialist and the issuer.

Impaired Objectivity

In addition to the concerns discussed above, we do not agree that if a specialist's objectivity is impaired, the auditor should automatically be precluded from using the work of that specialist. The potential amendment effectively removes the ability of the auditor to apply additional audit procedures and continue to use the work of the specialist, for example, when certain relationships are identified. Objectivity should be viewed as a continuum that affects the nature, timing, and extent of audit procedures, based on the auditor's judgment. Therefore, any amendments to the standards should acknowledge the importance of auditor judgment and the auditor's overall risk assessment when evaluating whether a specialist's objectivity is impaired.

III. Using the Work of a Company's Specialist

The PCAOB's oversight observations identified in the Consultation Paper²² might be indicative of opportunities for enhancements to expand the requirement to obtain an understanding of the nature of the work to be performed by the specialist²³ and clarify what is needed to obtain sufficient appropriate audit evidence under the existing standards. The auditor should assess the risks of material misstatement, and design and implement responses to the risks of material misstatement²⁴ when using the work of a company's specialist. We believe the Staff should consider potential enhancements to AU336 that are consistent with paragraph 8 of International Standards on Auditing 500, *Audit Evidence* (ISA500), which describes how the auditor should evaluate information prepared using the work of a company's specialist and the extent to which the information can be used as sufficient appropriate audit evidence. Therefore, we also support considering relevant guidance included in the Application and Other Explanatory Material section of ISA500,²⁵ which would provide the auditor with a framework to continue to apply auditor judgment and evaluate the related assessed risks when determining which of those procedures should be performed based on specific facts and circumstances of an audit engagement.

We recognize the need for additional guidance to enhance compliance with AU336, and propose that the Staff retain and enhance the extant guidance in AU336 that states the appropriateness and reasonableness of the methods and assumptions used and their application are the responsibility of the specialist.²⁶ These

¹⁹ Ibid.

²⁰ Page 50, the Consultation Paper.

²¹ Paragraph A20, ISA620.

²² As noted on Page 23, the Consultation Paper.

²³ Paragraph 9, AU336.

²⁴ Paragraph 3, AS12.

²⁵ Paragraphs A35 – A49, ISA500.

²⁶ Consistent with paragraph 12, AU336.

enhancements could include the following, many of which are proposed amendments in the Consultation Paper for the auditor's specialist:

- Require evaluation of the knowledge and skill of the company's specialist, including the Staff's proposal to add additional emphasis to that evaluation;²⁷
- Clarify that the auditor's evaluation of the appropriateness and reasonableness of methods and significant assumptions could include consideration of whether assumptions and methods are:
 - Generally accepted within the field of the specialist;
 - Consistent with the requirements of the applicable financial reporting framework;²⁸ and
 - Dependent on the use of specialized models.
- Focus the auditor's efforts on the assumptions that are significant to the development of the estimate and consider management controls over the estimation process.

a. Evaluating the Objectivity of a Company's Specialist

Assessing the objectivity of a company's specialist is not a simple "yes-no" question, but rather more appropriately reflects a continuum that impacts the auditor's consideration of the appropriateness of the evidence obtained from the specialist. When evaluating the objectivity of a company's specialist, an auditor could consider, among other things:

- Any interests and relationships that create threats to the specialist's objectivity, such as self-interest threats, advocacy threats, familiarity threats, self-review threats, intimidation threats, and any applicable safeguards, including any professional requirements that apply to the specialist, and evaluation of whether such safeguards are adequate;
- Threats to a specialist's objectivity posed by an employment relationship and whether there is any direct reporting by the specialist;
- The terms of the agreement to engage the specialist, including whether, and if so, how, the payment structure is tied to a particular outcome;
- Whether management has the ability to suggest or require revisions to the specialist's results before finalization;
- The significance of the relationship between the engaged specialist and management (i.e., whether the specialist has an extensive relationship with management, and whether the fees charged by the specialist are material to the specialist); and
- The nature of other services provided by the specialist to the company.²⁹

If the auditor believes the specialist's objectivity might be impaired, the auditor would use knowledge of the risks related to the particular accounting estimate to determine what additional procedures should be performed with respect to some or all of the specialist's assumptions, methods, or conclusions, including whether the auditor should consider engaging an auditor's specialist for that purpose.³⁰ The auditor should perform additional procedures when, in the professional judgment of the auditor, such procedures are needed as a result of risk assessment procedures or as a result of evaluating the audit evidence obtained in order to reach a conclusion.

These enhancements would provide the auditor with additional guidance on how to evaluate reliability and relevance of the audit evidence provided by the company's specialist and would allow the auditor to use the work of company's specialist as evidential matter in performing substantive tests.

²⁷ Page 36, the Consultation Paper.

²⁸ Pages 40 – 41, the Consultation Paper.

²⁹ Consistent with paragraphs A38 – A44, ISA500.

³⁰ Consistent with paragraph 11, AU336.

The CAQ is supportive of the Staff's consideration of developing potential revisions related to the auditor's use of the work of specialists, and commends the Board and its Staff for advancements made in this important area. Given the wide range of accounting estimates, including fair value measurements, that benefit from the expertise of valuation specialists, appraisers, actuaries, and other specialists, enhancements to the auditing standards and guidance will require careful deliberation and extensive outreach with key stakeholders to ensure the development of guidance that promotes audit quality, is operational and adaptable to changes in the evolving capital markets, and continues to recognize that auditors may need to use the work of a specialist when the audit requires specialized knowledge and subject matter expertise in a field other than accounting or auditing. The CAQ appreciates the opportunity to comment on the Consultation Paper and would be pleased to discuss our comments or answer any questions that the Staff or the Board may have regarding the views expressed in this letter.

Sincerely,



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Executive Director
Center for Audit Quality

cc:

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