



PCAOB Staff Consultation Paper No 2015-01: The Auditor's Use of the Work of Specialists

ICAEW welcomes the opportunity to comment on the *PCAOB Staff Consultation Paper: The Auditor's Use of the Work of Specialists* published by PCAOB on 28 May 2015, a copy of which is available from this [link](#).

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MAJOR POINTS

Management and auditors need to be more involved in the work of specialists.

1. This Staff Consultation Paper (the Paper) is welcome. The use of specialists is of increasing significance as audit becomes more of a multi-disciplinary process. Companies and the auditing profession are on a steep learning curve as financial statements become technically more complex, but this is not the first time this has happened. The development of the auditing profession from its beginnings in the 19th Century has been characterised by increasing expectations regarding the skills auditors should master, and the extent to which they should ask questions, probe and apply professional scepticism.
2. The profession has not always welcomed pressure to do more but history shows auditors benefitting every time it meets the challenge and develops new skills. This is one reason why the profession has not just survived, but continues to flourish. The idea that auditors' responsibilities are limited to ensuring that invoices have been posted to the correct accounts in the correct accounting period, and that there is no need for them to question inventory levels, inspect properties or kick tyres, is long gone. Working with specialists is just a continuation of this theme and neither management nor auditors should attempt to reduce their respective responsibilities in this area by passing responsibility to each other, or to the specialists involved. If all that can be reasonably expected is that auditors read the letters on file from specialists confirming a valuation, and limit their enquiries to any obvious errors, omissions or inconsistencies, auditing will come to be seen as a low-value post-room management exercise.
3. Management and auditors have to raise their game by actively challenging specialists' assertions, and particularly the assumptions they have made. If, for example, assumptions used by specialists in a valuation model are different to observable market data, or if a data set used as a basis for projections covers a very short period, investors can reasonably expect management and auditors to ask why. If they fail to do so, investors will rightly ask why they did not, and both will lose credibility. Auditors will pay a price if they seek to portray themselves as highly-qualified project managers, supervising the work of others, but remaining largely uninvolved in the detail.
4. No-one should be afraid of complex valuation models. If auditors do not understand them, they must ensure that they have an appropriately qualified specialist available, preferably an audit-literate one, with whom they are willing and able to communicate. Most importantly, auditors must be prepared to ask simple and direct questions, to demand answers that they understand, and to ask for changes to be made when the answers do not seem right.

The Staff Consultation Paper would benefit from strategic direction from the Board, more focus on substance and less on process.

5. The Paper does make some reference to these strategic issues and in particular to the need for auditors to improve the nature and extent of their communications with specialists, which we applaud. However, the Paper, and its next iteration in the project, would benefit from more high-level focus and strategic direction from the Board. The 48 questions are detailed and repetitive, and mainly lacking in any genuine sense of enquiry. This is one reason we have not attempted to answer all of them. It is also the reason for the number of instances in which we have cross-referred one answer to another in our response.
6. It is hard to avoid the impression that Staff have already have answers to the questions they have asked. Staff have presumably consulted extensively with firms and appear to be seeking confirmation of what they already know. More importantly, it is equally hard to avoid the impression that Staff have already decided on likely outcomes, and are not really interested in alternative approaches. This is consultation the wrong way round. It would be better to ask a relatively small number of questions in an attempt to gauge high levels views among different

stakeholder groups, and then develop the detail. Such an approach might have avoided the need for some recent re-proposals.

7. We believe that this project needs a substantially different focus if changes to standards are to be effective. The current focus is on process at the expense of substance - on the formal relationships, the categorisation of specialists and on the need for auditor specialists to check what management specialists have done. Very little directly addresses the problem of auditors failing to challenge the substance of the assumptions or methods used by specialists.

The PCAOB should acknowledge the scale of the task facing auditors, the costs involved and operational issues that cannot be dealt with by auditing standards alone.

8. US guidance currently permits auditors to avoid responsibility for assumptions and methods used by some specialists, which is no longer acceptable, and is not in accordance with ISAs. However, any paper purporting to improve audit quality by introducing new requirements for auditors to take more responsibility for the valuations specialists produce, needs to reflect and address a number of operational issues that are not standards-related.
9. Operational challenges regarding the use of the work of specialists that cannot be fixed by amending auditing standards include:
 - a shortage of certain specialists leading to independence and objectivity issues; and
 - the fact that specialists, regardless of whether they work for companies or auditors, and regardless of whether they are employed or engaged, do not speak the same language as auditors.
10. Specialists who do not understand what they are being asked for, or why, and who are reluctant to communicate with auditors in terms other than their own, are a widespread problem. This issue warrants more recognition than the Paper gives it.
11. The PCAOB should not underestimate the scale of the task or the costs involved. Additional requirements will lead to increased costs. Provided the benefits in terms of improved audit quality are commensurate, that is acceptable, but we fear that they may not be.

Treating information produced by management specialists as if it is produced by the company and requiring auditors to employ other specialists to review it, is likely to have perverse consequences.

12. The proposals to require auditors to treat information prepared by company specialists as if it is prepared by the company will increase costs, and discourage companies from using specialists.
13. Companies, particularly smaller companies, may cease engaging or employing their own specialists, and instead challenge auditors to prove management calculations wrong, or effectively rely on the numbers the auditor's specialist produces. The idea that legal counsel can be provided to a company and that auditors would then need to get another opinion on a routine basis is absurd. It defeats the point of management employing or engaging a specialist and would have the perverse effect of discouraging the use of specialists by companies, and encouraging directors to perform their own valuations and leave it to the auditors to employ a proper valuation expert to make sure that it is right. This has auditors dangerously close to taking responsibility for the valuation. If the PCAOB does go down this route (and we do not believe that it should) the alternative suggested – requiring auditors to employ another specialist only where information is produced by a company's *employed* specialist – would be preferable to a blanket requirement applying to *all* specialists employed or engaged by the company.

The PCAOB should future-proof auditing standards and make sure that they work now in jurisdictions in which IT and tax specialists are not part of the audit team.

14. There are inconsistencies in the definitions of specialists. Firms have differing practices. IAASB standards scope out accounting and auditing experts, but tax practitioners dealing with complex or unusual issues are scoped in. The proposed PCAOB definition is the same on the face of it but IT and income tax specialists are scoped out.
15. The situation is changing. In future, it is likely that many more specialists will be integrated within audit teams. This is a good example of a situation in which a principles-based approach is much more likely to have the desired effect on auditor behaviour than any attempt at defining who is caught and who is not in any given situation. The PCAOB's standards are applied world-wide and there will be many jurisdictions in which it would be wholly inappropriate to scope out IT and tax specialists because the profession and firms are structured very differently to the way they are in the USA.
16. The important point is that auditors should be more careful than they are now in supervising *all* individuals involved in the audit who are not trained auditors, or do not regularly provide audit support, and may not have a good understanding of audit methodologies. This would not change the position with respect to many income tax and IT specialists, but it would serve to scope out other specialists, such as valuation specialists who are now regularly involved in purchase price allocations, and others who in the future become more integrated with the main audit practice. More importantly, it would not inappropriately scope out tax and IT specialists in situations in which they really do need close supervision.
17. If the standard must scope out tax specialists, the focus should be not on the nature of the tax (income tax) but on its unusual or complex nature, as in the ISAs.

Distinguishing between specialists employed and engaged by firms and companies respectively is unnecessary.

18. Distinguishing between those specialists employed and engaged by firms and companies respectively over-complicates the issue. Distinguishing between independence and objectivity at this high level is and always has been difficult. No-one being paid to do a job can ever be absolutely independent, regardless of whether they are employed or engaged and there are in practice degrees of objectivity and independence that are not recognised in auditing or ethical standards. The most important distinction is between those employed and engaged by the auditor, and those employed or engaged by the company. The softer distinction between employment and engagement *can* be recognised and dealt with as part of the risk assessment on individual audits, and by scaling the response accordingly. Other risks that should be acknowledged include the risks involved where management influences the methods and assumptions used.

The PCAOB should acknowledge that the education of auditors and enforcement are relevant.

19. We agree that extant PCAOB standards do not adequately address a number of issues but we do think that the education of auditors and enforcement are important. If enforcement of existing standards is not resulting in compliance with those standards, in which the requirements are significantly less onerous than those proposed, absent any attempt to address the reasons for non-compliance in terms of education and enforcement, it seems likely that enforcement of new standards will be even more of an issue. Are auditors any more likely to comply with new standards if they cannot be persuaded to apply the existing ones properly?

Scoping auditor work on assumptions and methods is critical.

20. Standards need to better address the nature and extent of auditor work on methods and assumptions used by specialists, and auditors should be encouraged to challenge specialists when considering the reasonableness of assumptions and methods used. But we caution

against creating expectations, explicit or implicit, that auditors will be in a position to critically evaluate well-established and widely-used methods and assumptions within an industry, still less in more specialised areas.

21. We should all be mindful of instances in which professional bodies, standard-setters and regulators have been rightly admonished for failing to address egregious weaknesses in assumptions and methods in professional practice. These include the actuarial tables used in the pensions industry for many years based on assumed life expectancies that were decades out of date. However, *individual auditors* cannot reasonably be expected to critique established professional practice outside their own professional expertise. They do not have the locus or the skills to question or choose between established methods or standardised assumptions, not least because those methods and assumptions are intended for use by specialists. Even when there are alternative methods from which choices can be made, auditors are unlikely to be in a position to make an effective judgement about whether an appropriate choice has been made.
22. However, *a distinction might be made between auditor work on variable assumptions, and auditor work on methods and standardised assumptions*. Methods are generally fixed and some assumptions are standardised, used by convention or mandated by professional bodies or regulation. Auditors are less likely to be able to critique these effectively than they are the more variable assumptions that are not standardised.

RESPONSES TO SPECIFIC QUESTIONS

Q1: Does the information presented in Section III accurately characterize current practice? Are other aspects of current practice – at larger and smaller accounting firms – relevant to the staff's consideration of potential standard setting in this area?

Q2: Are there any challenges associated with current practice, especially for those accounting firms that have incorporated the standards of the IAASB or of the ASB into their audit methodologies?

23. The information presented in Section III broadly characterises current practice but it glosses over some important higher-level issues that standards may not be able to address fully. These issues should be recognised and taken into account as new standards and guidance are developed.
24. Common day-to-day logistical difficulties in communicating with specialists arise from the fact that specialists are often unfamiliar with the specialised language used by auditors and vice versa. Auditors have difficulties explaining to specialists the requirements of auditing standards regarding the design and implementation of controls and control deficiencies, for example. More emphasis on the need for auditors to properly communicate the nature and extent of adequate audit documentation in these areas to specialists would be helpful, but auditing standards are not the right place for detailed guidance. The PCAOB might consider encouraging or facilitating liaison between professional bodies representing auditors and the larger bodies representing valuations and pensions experts, for example.
25. More is needed on high-level, up-front communications between auditors and specialists, as well as on the specifics of what is to be communicated, and output. The proposals provide considerable detail on the content of agreements between auditors and specialists, but more emphasis is needed on a high-level review of who does what to ensure that nothing falls between the cracks.
26. On balance, we believe that the four 'buckets' on page 8, distinguishing between those employed and engaged by firms and companies respectively, over-complicates the issue. Distinguishing between independence and objectivity at this high level is and always has been difficult. No-one being paid to do a job can ever be absolutely independent, regardless of

whether they are employed or engaged and there are in practice degrees of objectivity and independence that are not really dealt with in auditing or ethical standards. Treating them as if they are hard distinctions is not helpful.

Q3: For accounting firms that use the work of an auditor's specialist:

- a. Does the firm employ or engage those specialists? How does the firm decide to employ versus engage a specialist? For larger firms that employ specialists, are there circumstances when the firm uses engaged specialists? If the firm employs and engages specialists, describe the relevant ways in which each may be used in an audit.
- b. Does Figure 1 in Section II.A accurately describe the activities for which the firm uses the work of a specialist? What other specialized knowledge and skill do specialists have and in what areas of the audit is their work commonly used?
- c. What type of work do the specialists perform? Does the type of work vary depending on whether the firm employs or engages the specialist? Does the type of work vary depending on the specialist's field of expertise?
- d. Is the auditor's specialist more likely to assist in testing the company's process or developing an independent estimate? Why?

Q4: For accounting firms that use the work of an auditor's employed specialist:

- a. Does supervising the work of employed specialists in accordance with Auditing Standard No. 10 present any challenges?
- b. How does the firm evaluate whether the work was performed and whether the results of the employed specialist's work support the conclusions reached?
- c. Does this evaluation vary by the nature of the specialization and degree of the auditor's familiarity with that particular specialization?
- d. How would the evaluation change if the firm engaged the specialist?
- e. What is the process for determining whether more senior specialists in the firm, such as partners or principals, should assist the auditor in supervising the work of the specialist? How does that assistance affect the auditor's supervision of the work of the employed specialist?

Q5: For accounting firms that use the work of an auditor's engaged specialist:

- a. What process does the firm use to assess the knowledge and skill of a specialist before engaging the specialist?
 - b. Are there circumstances when the auditor performs procedures in addition to those specified in AU sec. 336 to evaluate the work of the specialist (e.g., performs procedures similar to those in Standard No. 10)? If so, describe those circumstances and the reasons for using that approach. Do senior specialists in the firm (if any), such as managers and partners, assist in evaluating the engaged specialist's work?
 - c. How does the firm apply the requirements of AU sec. 336, in conjunction with the risk assessment standards, to the use of the work of an engaged specialist?
 - d. In using the work of an engaged specialist, does the firm have access to all the methods and models of that specialist or are there instances when access to proprietary methods or models is restricted by the specialist or the specialist's employer?
27. The employment or engagement of a specialist is determined by demand for expertise both generally and within the firm, and its availability in the market-place. Larger firms seek to employ specialists whose skills are required on an on-going basis.

28. Auditor specialists are more likely to test the company's process than to develop an independent estimate.
29. There are situations in which firms do not have access to all the methods and models of engaged specialists and when access to proprietary methods or models is restricted by the specialist or the specialist's employer. We do not think this difficult situation can be resolved by imposing ever more demanding requirements in auditing standards. When the amounts involved are not material, there is often little that can be done. Please see our answer to question 8 for further observations on this issue.

Q6: For accounting firms that use the work of a company's specialist:

- a. What are the circumstances in which the firm uses the work of a company's specialist? If so, describe the related audit procedures performed in connection with the specialist's work. Are there circumstances when the auditor performs procedures in addition to those specified in AU sec. 336 to evaluate the work of the specialist? If so, describe those circumstances and the reasons for using that approach.
- b. Does Figure 1 in Section II.A accurately describe the activities for which the auditor uses the work of a company's specialist? Are there other activities in which the auditor uses the work of a company's specialist that should be considered within the scope of this project?
- c. In what circumstances has the firm concluded that the findings of the company's specialist were unreasonable and therefore performed additional procedures, as required by AU sec. 336? In those circumstances, what procedures did the auditor perform?
- d. How does the firm currently apply the requirements of AU sec. 336, in conjunction with the risk assessment standards, to the use of the work of a company's specialist?
- e. Are there any differences between how the firm uses the work of a company's employed specialist and a company's engaged specialist?
30. It is rare for a firm not to at least attempt to use the work of a company's specialist and it would be perverse to do otherwise. We are not aware that firms conclude that the findings of a company's specialist are unreasonable and perform additional procedures on a regular basis.

Q7: This section provides the staff's views about the need to improve the standards based on issues related to the standards, inspections observations, and the views of the SAG. Do commenters agree with the staff's analysis of the need to improve standards? Are there other issues the staff should consider with respect to this need?

31. On balance, we believe that some refinement of existing standards is needed. However, it is important to recognise, as the Paper does, that changes to standards will not necessarily change auditor behaviour. We are puzzled by the apparent assertion in the last sentence of the first paragraph on page 24, to the effect that auditing standards need to be made more robust because auditors are not complying with existing standards. If that is the case, as inspection findings show and as seems likely, it is surely *education and enforcement* that need to be addressed. How are new standards likely be more effective if auditors are not applying the existing standards properly?
32. The alternatives to standard-setting discussed on page 26, such as the development of additional guidance or the devotion of additional resources to inspection and enforcement, have been too easily dismissed by Staff. Education and enforcement are equally, if not more, likely than standard-setting to change auditor behaviour.
33. We do not agree that more specificity about how to supervise auditors' specialists will necessarily benefit auditors or, more importantly, investors. We re-emphasise our long-held belief that principles-based standards are, in the long run, better tools for both auditors and regulators. They are surely harder to develop than rules-based standards but rules-based standards do not permit regulators to challenge auditors effectively and they encourage both

auditors and regulators to hide behind the rules. Principles-based standards only work where regulators have the confidence to apply them and principles-based regulation requires regulators to use their judgement. The PCAOB and its Staff need to consider these issues and to think again about the sustainability and value of a rule book that grows ever longer.

Q8: When an auditor obtains an understanding of the methods used by the company's specialist:

a. If the auditor has access to the specialist's methods (or models), is that access at a sufficiently detailed level (as opposed to a general level, such as a website description) to allow the auditor to obtain sufficient appropriate audit evidence?

b. If the auditor does not have such access, how does the auditor obtain sufficient appropriate audit evidence regarding the relevant assertion?

34. There is a general problem with the auditability of proprietary methods and models and data, the detail of which is not publicly available. An unpalatable fact not yet widely acknowledged is that this type of situation is becoming more common. Auditors often struggle to obtain sufficient, appropriate audit evidence, but because the amounts involved are not material, there is often little that can be done. The issue is not one that can be resolved simply by ever more demanding auditing standards.
35. It is unrealistic to believe that requiring auditors to obtain more information in these circumstances will be effective. No amount of pressure from auditors or others in the financial reporting supply chain will persuade the owners of these proprietary methods, models and data to release the necessary information in the absence of an obligation to do so. Requiring auditors to avail themselves of the specialist expertise needed to develop independent models when that expertise is effectively unobtainable is likely to be similarly ineffective.
36. The issue is partly one of accounting standards which require the fair valuation of many assets, particularly opaque financial instruments and intangible assets in business combinations. The issue is also partly one for those who regulate the markets in which opaque financial instruments are traded, and we encourage the PCAOB, as we have other regulators, to liaise more closely with these stakeholders to address this issue.

Q9: Are revisions to PCAOB standards the most appropriate way to address the issues as discussed in this staff consultation paper? Are there other alternatives that should be considered?

37. Please see our answer to question 7.

Q10: Should the auditor perform the same procedures when using the work of an auditor's engaged specialist as those required for an auditor's employed specialist?

Q11: Are there other considerations related to the alternatives presented that the staff should be aware of?

Q12: Are there other alternatives related to the auditor's use of the work of an auditor's specialist that would result in the consistent treatment of the work of an auditor's employed and engaged specialist? If so, explain the other alternatives.

Q13: Are there any limitations on an auditor's ability to treat the work of an engaged specialist the same way as that of an employed specialist?

38. Distinguishing between those employed and engaged by auditors and companies respectively over-complicates the issue. The distinction between independence and objectivity is not absolute because no-one being paid can ever be wholly independent, regardless of the contractual arrangements. In practice there are degrees of objectivity and independence.

39. The most important distinction is between those employed and engaged by auditors, and those employed or engaged by companies.
40. The softer distinction between employment and engagement can be recognised and dealt with as part of the risk assessment and by scaling the response accordingly. Other risks that should be acknowledged include the risks involved where management influences the methods and assumptions used.
41. A better question would be, 'should auditors be required to assess and evaluate the work of auditors' engaged and employed specialists in the same way, applying the same criteria?' The answer would be 'yes'. The procedures are less important than the evaluation of the independence, objectivity, knowledge and skills of the auditor's specialist, the quality control, ethical and technical standards to which they are subject and which they are required apply, and the quality of the work that that they have performed.
42. Generally speaking, someone employed by a firm is less of a risk because they are subject to the firm's quality control requirements and can be more closely supervised than someone engaged by a firm. This will not always be the case though, where an employed individual has a senior role within the firm, for example, or where an engaged individual performs a great deal of work for the firm and works to detailed firm requirements. This is a judgement and plenty of guidance can be provided in auditing standards to support that judgement, but trying to take the judgement out of it altogether may well lead to dysfunctional behaviour, inefficient auditing and poorer quality audit evidence.
43. The development of a separate standard for using the work of auditor specialists would keep PCOAB requirements in line with the ISAs.

Q14: Is it appropriate for an auditor to consider the knowledge, skill, and objectivity of a company's specialist when evaluating the reliability of information provided by that specialist? If so, how might the company's use of the work of a competent and objective specialist under the potential alternatives affect the nature, timing, and extent of the auditor's procedures?

44. It is appropriate for auditors to consider the knowledge, skill and objectivity of a company's specialist when evaluating the reliability of information provided by that specialist. However, attempts to change company behaviour by changing auditing standards and putting pressure on auditors to put pressure on management are fraught with difficulties.
45. It is important to avoid situations in which information produced by company specialists is treated as if it is produced by the company, and requiring auditors to employ other specialists to review it. This is likely to have perverse consequences, including at the same time discouraging the use of specialists by companies, and encouraging reliance on specialists employed or engaged by auditors, with the attendant threats to independence and objectivity. It cannot be right that companies effectively leave valuations to auditors' specialists. If the intention is to persuade companies to use external specialists, it would be a great deal better to mandate external valuations under accounting regulations. We therefore believe that amending the AU sec. 336 requirements by removing the limitations on auditor responsibilities regarding the evaluation of company specialists is preferable to rescinding AU sec. 336.
46. If the PCAOB does go down this route (and we do not believe that it should) the alternative suggested – requiring auditors to employ another specialist only where information is produced by an company's *employed* specialist – would be preferable to a blanket requirement covering all specialists employed or engaged by the company.

Q15: How do auditors currently obtain an understanding of the assumptions and methods used by a specialist under AU sec. 336?

47. We agree that extant PCAOB standards do not adequately address the nature and extent of auditor work on methods and assumptions used by company specialists, and that auditors should be encouraged to challenge specialists and apply professional scepticism when considering the reasonableness of assumptions and methods used.
48. Auditors must not be afraid of complex valuation models. If they do not understand them, they must ensure that they have an appropriately qualified specialist available, preferably an audit-literate one, with whom they are willing and able to communicate. Most importantly, auditors must be prepared to ask simple and direct questions, to demand answers that they understand, and to ask for changes to be made when the answers do not seem right.
49. However, we caution against creating expectations, explicit or implicit, that individual auditors are in a position to critically evaluate well-established and widely-used methods and assumptions within an industry, still less in more specialised areas.
50. We should all be mindful of instances in which professional bodies, standard-setters and regulators have been rightly admonished for failing to address egregious weaknesses in methods and assumptions in professional practice. These include the actuarial tables used in the pensions industry for many years based on assumed life expectancies that were decades out of date. However, *individual auditors* cannot reasonably be expected to critique established professional practice outside their own professional expertise. They do not have the locus or the skills to question or choose between established methods or standardised assumptions, not least because those methods and assumptions are intended for use by specialists. Even when there are alternative methods from which choices can be made, auditors are rarely in a position to make an effective judgement about whether an appropriate choice has been made.
51. However, *a distinction might be made between auditor work on variable assumptions, and auditor work on methods and standardised assumptions*. Methods are generally fixed and some assumptions are standardised, used by convention or mandated by professional bodies or regulation. Auditors are less likely to be able to critique these effectively than they are the more variable assumptions that are not standardised.
52. The approach to obtaining an understanding of assumptions and methods should be determined less by whose assumptions and methods are being considered, and more by reference to the specific risks associated with the specialist concerned, their competence and experience. Once again, the focus on the categorisation of the specialist misses the point somewhat.

Q16: Should the work of a company's specialist be treated as audit evidence the same way as other information provided by the company? Are there concerns associated with more rigorous testing of the work of a company's specialist that may result from this approach? For example, would auditors increasingly need to employ or engage specialists to perform work to assist the auditor with such testing?

Q17: Are there other alternatives that would be a more appropriate response to the risks of material misstatement in areas where companies use the work of specialists? If so, what are those alternatives?

Q18: Are there any practical concerns with rescinding AU sec. 336? The staff is especially interested in the views of auditors, companies that typically use the work of specialists, and specialists, including those in specialized industries (such as oil and gas and environmental engineering). Are there other challenges associated with testing the work of a company's specialist?

53. Please see our answer to question 14 regarding treating information produced by company specialists as if it is produced by the company, and our answer to question 13 regarding the

distinction between those employed and engaged by auditors, and those employed or engaged by companies.

Q19: Are the potential definitions of an auditor's specialist and a company's specialist appropriate? If not, what would be alternative definitions for those terms?

Q20: Is it appropriate to retain the definition of a specialist from AU sec. 336 or is there a need to update the definition to reflect the increased use of the work of persons with specialized knowledge or skill in accounting and auditing? For example, should that definition also include those with specialized knowledge or skill in income taxes or IT?

Q21: Is it clear what constitutes a specialized area of accounting and auditing? For example, are persons with specialized knowledge or skill in regulatory compliance (e.g., related to audits of brokers and dealers) considered to be persons with specialized knowledge or skill in accounting and auditing? Should the staff provide clarification about what constitutes a specialized area of accounting and auditing? Does the discussion in this staff consultation paper appropriately describe when third parties may be inside or outside the scope of the potential definition of an auditor's specialist?

54. There are inconsistencies between the definitions of specialists in practice and auditing standards. IAASB standards scope out accounting and auditing experts, but tax practitioners dealing with complex or unusual issues are scoped in. The proposed PCAOB definition is the same on the face of it but IT and income tax specialists are scoped out. Recognising these inconsistencies is important but more important is the recognition that many firms are still not doing enough on the relevant financial statements assertion *regardless* of whether the individuals concerned are categorised as specialists. Focussing on the identity and qualifications of the specialist rather than on the audit evidence required may not be the most efficient approach.
55. The PCAOB's standards are applied world-wide and there will be many jurisdictions in which it would be wholly inappropriate to scope out IT and tax specialists. Auditors should be more careful than they are now in supervising *all* individuals involved in the audit who are not trained auditors or do not regularly provide audit support, and may not have a good understanding of audit methodologies. This will not change the position with respect to many income tax and IT specialists. However, it would serve to scope out other specialists, such as valuation specialists who are now regularly involved in purchase price allocations, and others who in the future become more integrated with the main audit practice. More importantly, it would not inappropriately scope out tax and IT specialists in situations in which they really do need close supervision.
56. We urge the PCAOB to consider the merits of the IAASB approach. If the standard must scope out tax specialists, the focus should be not on the nature of the tax (income tax) but on its unusual or complex nature, as in the ISAs. We do not think that either approach requires much clarification. We do not believe that IT specialists should be scoped out of the proposals because firms continue to struggle to recruit an appropriate level of resource into audit practices and to assume that such individuals are all sufficiently audit-literate for these purposes is a step too far at this stage.

Q22: Are the potential requirements to evaluate the knowledge and skill of an auditor's specialist clear and appropriate? Are there other alternatives to accomplish the objectives? Are there other factors that the auditor should consider?

57. We find nothing objectionable in the box on page 36 although it does not address all of the issues identified on page 23.

Q23: Are the matters described in the potential requirements on which the auditor and an auditor's specialist should reach an agreement sufficient and appropriate? If not, what other

matters should be required to be specified in the agreement before the auditor's specialist performs work to assist the auditor?

Q24: Are there any obstacles to reaching an agreement and documenting all of the categories of information described in the potential requirements? Would it be difficult to comply with some of the potential requirements? Are there other alternatives to accomplish the objectives?

58. Reaching an agreement and documenting the list of issues in the box on page 37 may not be appropriate when dealing with the auditors' employed specialists as it may effectively amount to one person in a firm asking another (the employed specialist) about the firm's own methodology. Restricting the list of matters to be covered to the higher-level list in paragraph 11 of ISA 620 might avoid an unnecessary and pointless compliance exercise in such cases. Requiring the documentation of the relevant communications might be less burdensome than requiring a written agreement in all cases.

Q25: Could the potential requirements for informing the auditor's engaged specialist of his or her responsibilities and reviewing the specialist's work and conclusions result in unintended consequences (e.g., tax or employee benefit consequences)?

Q26: How do accounting firms determine what information an auditor's specialist should provide to the auditor? Are there circumstances in which auditors may not retain all audit evidence obtained from the specialist?

59. The information to be provided by specialists to auditors is determined in all cases by the need to provide audit evidence to support the audit opinion.

60. We are not aware of situations in which auditor engaged specialists with access to proprietary models permitting auditors to review the models or data sets but without making any sort of record or taking notes, as sometimes happens in group audit situations.

Q27: Do the potential requirements appropriately reflect what the auditor's responsibilities should be when an auditor's specialist develops an independent estimate? How would these potential requirements differ from current practice (e.g., for audits performed in accordance with ISA 620 or AU-C Section 620)?

Q28: Do the potential requirements appropriately reflect what the auditor's responsibilities should be when an auditor's specialist tests the company's methods and significant assumptions? How would these potential requirements differ from current practice (e.g., for audits performed in accordance with ISA 620 or AU-C Section 620)?

Q29: Do the potential requirements appropriately reflect what the auditor's responsibilities should be when the auditor evaluates the results and conclusions of the work of an auditor's specialist? How would these potential requirements differ from current practice (e.g., for audits performed in accordance with ISA 620 or AU-C Section 620)?

Q30: Do the potential requirements provide appropriate direction for the auditor's consideration of any limitations, restrictions, and caveats in the report of an auditor's specialist?

Q31: Are the potential requirements for evaluating the work of an auditor's specialist appropriate for all types of specialists used in audits (e.g., valuation specialist, actuary, geologist, lawyer, or engineer)? If not, how should the potential requirements be tailored?

61. Please see our answer to question 15. .

Q32: How does the auditor evaluate relationships between an auditor's engaged specialist and a company under AU sec. 336?

Q33: Are the potential requirements under the enhanced objectivity approach for the auditor's use of the work of an engaged specialist appropriate and feasible?

Q34: Should the auditor's engaged specialist (and his or her employer) be required to meet the independence criteria of Rule 2-01? Are there certain types of specialists that would not be able to satisfy these criteria? Could these criteria affect the availability of specialists?

62. Specialist firms are unlikely to have the systems in place, nor be willing to invest in them, in order to be able to confirm their compliance under Reg. S-X Rule 2-01.

Q35: Are the potential requirements for the auditor to obtain information regarding business, employment, and financial relationships between the auditor's specialist (including his or her employer) and the company appropriate? If not, should other relevant factors be added to the potential enhanced objectivity requirements? For example, should the potential requirements take into account information barriers or other controls to address conflicts of interest at a specialist's firm?

Q36: Are the potential requirements for the auditor to evaluate the objectivity of an auditor's specialist appropriate? Is it appropriate to apply the reasonable investor test as an overarching principle in assessing the specialist's objectivity? If not, are there other relevant factors that would be helpful to add to the potential requirements? For example, should the potential requirements take into account "threats" to objectivity and 'safeguards' to reduce the threats, as provided in ISA 620?

Q37: Does the enhanced objectivity approach provide sufficient assurance that the work of an auditor's engaged specialist will not be influenced by business, employment, or financial relationships?

Q38: Is the potential requirement that the auditor obtain information about the process used by the auditor's engaged specialist to formulate the responses to the auditor's request for information appropriate and sufficiently clear? If not, are there other relevant factors that would be helpful to add to the potential requirement?

Q39: Does the specialist (or his or her employer) typically have a system in place capable of tracking the information to respond to the auditor's request? If not, could a system feasibly be created?

Q40: For accounting firms that use the work of an auditor's or a company's specialist for public company audits:

a. In how many (e.g., what percentage) of those audits is the work of specialists used? Provide details within the following categories:

- (i) Auditor's employed specialists;**
- (ii) Auditor's engaged specialists;**
- (iii) Company's employed specialists; and**
- (iv) Company's engaged specialists.**

b. For the auditor's specialists described in a.(i) and a.(ii), what is the ratio of specialist hours to total audit hours?

c. How are the auditor's engaged specialists compensated?

Q41: What are the likely economic impacts, including benefits and costs, of the potential alternatives discussed in this staff consultation paper? Are there any unintended consequences not already identified that might result from the alternatives?

Q42: To what extent would the potential alternatives help to improve audit quality or reduce the incidence of undetected misstatements, audit deficiencies, and fraud?

Q43: Would any of the potential alternatives lead to increased cost? If so, what are the estimated (i) number of audits affected and impact on audit hours and cost and (ii) effects on companies' costs?

Q44: Do the incremental costs associated with any of the potential alternatives decline as an accounting firm uses specialists more frequently?

Q45: Are the costs of the potential alternatives likely to be reduced in years after the year of initial implementation?

Q46: Are the economic impacts of the potential alternatives likely to be different for audits involving (i) emerging growth companies, (ii) brokers and dealers, (iii) companies in specialized industries, (iv) companies in certain stages of their life cycles (e.g., development stage), and (v) the use of the work of specialists in specific fields of expertise? If so, provide relevant details.

Q47: Are the economic impacts of the potential alternatives likely to affect accounting firms of different sizes differently? If so, provide relevant details. Are there other alternatives that might address the need for improvement noted in this staff consultation paper at lower cost or greater efficiency?

Q48: As part of considering the need for change, the staff is analyzing academic literature that relates to the auditor's use of the work of a specialist.¹⁰⁴ Is there ongoing research or other information, other than that identified in this staff consultation paper, that the staff should consider in evaluating the economic aspects of changes in standards for the auditor's use of the work of a specialist?

63. The PCAOB should not underestimate the costs involved in the alternatives suggested by Staff. Additional requirements will surely lead to increased costs. Provided that the benefits in terms of improved audit quality are commensurate, that is acceptable. However, we fear that the proposals to require auditors to treat information prepared by company specialists as if it is prepared by the company may increase costs disproportionately, particularly for smaller companies.