



July 31, 2015

Office of the Secretary
Public Company Accounting Oversight Board
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Via Email to comments@pcaobus.org

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

Dear Board Members and Staff:

Grant Thornton LLP appreciates the opportunity to comment on Staff Consultation Paper No. 2015-01, *The Auditor's Use of the Work of Specialists* ("Consultation Paper") developed by the staff of the Office of the Chief Auditor ("staff") of the Public Company Accounting Oversight Board ("PCAOB" or "Board"). We agree with the staff that the use of specialists has increased over the years and many of the areas in which they are utilized have grown in complexity. We commend the staff's efforts on this topic as well as the Board's outreach activities thus far. We support the staff's proceeding with this project in conjunction with the auditing accounting estimates and fair value project since these two topics are so interrelated.

Potential need for improvement

While we agree improvement could be made to AU Section 336, *Using the Work of a Specialist* ("AU 336"), we see a common theme in the Board's observations of failure to comply with the current standard as opposed to an indication that the standard itself is fatally flawed.

We also note that many of the observations discussed at the Standing Advisory Group meeting held on June 18, 2015 ("June SAG meeting") and in previous meetings tend to relate to fair value accounting and in particular fair value accounting matters related to financial instruments. While we recognize this is a critically important area of financial reporting, we also would highlight, as the Consultation Paper also notes, that specialists are used in many capacities by management and the auditor, and it is important to remain cognizant of that in considering any potential changes.

With respect to supervision and review of the auditor's specialist, we acknowledge the comments in the Consultation Paper regarding issues that may have arisen with respect to insufficient oversight and lack of coordination, among other issues. However, we do not believe that the issues suggest the need to propose new requirements that would be prescriptive for each estimate within an engagement where an internal or external auditor specialist is used.

With regard to the Consultation Paper's discussion as to possible revisions to the standards, we have summarized our views on key concepts that we believe should be considered in those proposed changes:

- Any proposed changes should be driven by the need to improve audit quality and the auditor's identification of and response to risks of misstatements; essentially, the methods used, key assumptions, use of appropriate inputs, and alternatives considered particularly in situations with high measurement uncertainty. We would be concerned that adding multiple procedures in other areas for all engagements (for example enhanced communication protocols) may result in losing focus on addressing the important areas noted above.
- We believe AU 336 should be retained and any enhancements should remain principles-based and allow for auditor judgment and scalability. We believe it is important to retain this standard to broadly address the various auditor specialists that could be used in a particular engagement and also to differentiate the supervision and review responsibilities between an engaged versus employed auditor specialist.
- We agree with the notion highlighted in the Consultation Paper (from extant AU 336) that the auditor is not expected to have the same degree of expertise as the specialist. We believe this is an important point for the staff to consider in deliberating revisions, in particular those related to comments in the Consultation Paper regarding an auditor "evaluating" the work of the specialist versus "understanding" the specialist's work. We are concerned that "evaluating" could be taken to mean that the auditor would need to have the same skillsets as the specialist to be able to conclude on the reasonableness of the specialist's work (which could imply an approach requiring one specialist to evaluate another specialist's work) and result in duplicative efforts. We believe the concept of "evaluating" in this circumstance should be clear that the auditor is evaluating the judgments and conclusions reached by the specialist, for example, the assessments of key assumptions and sensitivity implications of those assumptions on an estimate, and the contradictory evidence that may have been identified and considered by the specialist, in the context of potential misstatements- not in the context of a corroborating the methods and assumptions used as appropriate..
- We encourage the staff to continue to monitor and consider how other profession initiatives (e.g. the AICPA's projects to develop valuation certifications) may impact the nature and extent of any proposed changes to the standards. As discussed at the June SAG meeting, the valuation industry is currently not tethered by licensure or certifications, which if implemented could support the reliability of the work product provided by such specialists.

We have provided detailed comments below to address certain of the questions posed in the Consultation Paper.

Current practice

The Consultation Paper provides a reasonable characterization of current practice. We also believe that the International Standards of Auditing (“ISAs”) or auditing standards generally accepted in the United States (“US GAAS”) are well understood and provide a solid foundation and relevant application guidance for designing audit procedures regarding the use of auditor specialists and addressing situations where management has employed a specialist.

With respect to our use of audit specialists, Grant Thornton LLP both employs and engages specialists depending on the subject matter. For example, the firm employs actuaries and valuation specialists that provide support to audit teams. The firm will engage specialists for investment fair value pricing and for estimates unique to specialized industries, such as oil and gas derivative instruments or certain real estate appraisals. The firm will also use the work of the company’s specialists (whether employed or engaged) in instances where testing management’s process is deemed to be the appropriate audit response.

The Consultation Paper seeks information relative to firms’ use of specialists; following is a brief summary addressing certain of the staff’s questions.

Company’s specialists

The work of company specialists (whether employed or engaged) is typically utilized in situations where audit teams test management’s process. Generally, audit teams use the requirements of AU 336 as a baseline when using the company specialist’s work in developing an appropriate audit response. However, the facts and circumstances of the engagement may take the audit team beyond the requirements in AU 336 as allowed by paragraph 12 of the standard. For example, the audit team may determine there is a heightened risk with respect to a company’s employed specialist, especially if that individual participated in a bonus or profit-sharing program, since this could impact that specialist’s objectivity. Further, the assessed misstatement risk associated with accounting information developed by an engaged company specialist may increase if the auditor’s past experience with the work product of that specialist was unfavorable.

Determining the appropriate audit response in situations involving using the work of company specialists is driven by the audit team’s risk assessment; further procedures may be performed when the risk warrants it. This could include asking management for additional support beyond that provided by the company’s engaged specialist. In rare cases, the firm has recommended that the company consider replacing an engaged specialist based on a determination that the initial specialist engaged was not deemed competent.

Auditor’s employed specialists

While operational issues may occur with regard to communication (scope, addressing exceptions, etc.) between the auditor and the employed specialist, we believe that Auditing Standard No. 10, *Supervision of the Audit Engagement* (“AS 10”) provides sufficient principles-based requirements. In addressing these execution issues, the staff may rather consider other forms of guidance that could potentially alleviate such issues.

Specialists often participate in the risk assessment and fraud brainstorming meetings. These meetings are typically where the audit team will communicate the scope, expectations, and responsibilities of the specialist. This often includes which party is responsible for testing the completeness and accuracy of management's data. Communication continues at various points in the audit process as deemed necessary by the audit team. Generally, the specialist provides the audit team with a memo that highlights the procedures performed and conclusions reached. The audit team then considers whether additional work needs to be performed in order to conclude that they have obtained sufficient appropriate audit evidence. In most public company audit situations, the work of the specialist will also be subject to a review by a senior valuation specialist employed by the firm. The level of senior specialists' review is determined based on the risk associated with the unit of audit and the relative experience of both the specialist and the audit team.

Auditor's engaged specialists

The firm will engage outside specialists in circumstances where the skills/expertise cannot be found in-house. Due diligence on the more commonly used specialists is performed at the national level and includes centrally assessing the qualifications of the specialist and the typical methodologies used. Individual audit teams then supplement this global assessment with an assessment in the context of the facts and circumstances of the engagement.

The rigor of procedures performed on the engaged specialist's work is driven by the risk assessment, and generally we believe audit teams perform the requirements as set forth in AU 336. The firm is granted access to methods and models in many situations, but not always. In situations where access is not provided, firm specialists will usually assist in evaluating the key inputs and inquire as to the general workings of the model. We have noted that occasionally a "shadow calculation" may be performed by the firm's specialist to provide further evidence as to the reasonableness of the estimate. However, as noted above, this is typically done when the risk warrants it.

Company's specialists

Alternative for revising standards

With respect to company's specialists, we continue to be supportive of clarifying enhancements as opposed to changes in the current requirements. We note that for certain companies that do not employ staff with expertise in various specialty areas, the company's use of third party specialists may serve to reduce the assessed risk of material misstatement (for example the use of an experienced external specialist to perform a business combination purchase price allocation as opposed to less qualified internal personnel). We acknowledge the staff's concern with respect to the notion in the current standards that the appropriateness and reasonableness of methods and assumptions used and their application are the responsibility of the specialist. However, we believe teams typically approach these situations with the recognition that an auditor specialist would assist in evaluating the competency of the company's specialist as well as the reasonableness of the conclusions reached. In those situations, the teams will not simply accept the amounts put forth by the company's specialist. Depending on the risk assessment, the auditor will determine the nature and extent of testing the audit team and their specialist will

perform. We believe paragraph 12 of AU 336 provides the auditor with the ability to do a “deeper dive” in instances where the perceived risk related to the specialist’s work is heightened.

We are concerned that certain potential changes highlighted in the Consultation Paper would result in more prescriptive requirements to test a specialist’s models and completeness and accuracy of other data with the same rigor in all circumstances, rather than aligning with a risk-based audit approach. Rather, we believe the focus generally should be on the inputs. As discussed at the June SAG meeting, models are usually very similar and the variations of an output are driven more by the inputs. For example, in a derivatives valuation, the auditor is typically familiar with the generally accepted method of valuation and therefore focuses their tests on the inputs and agreeing management’s financial information to the underlying records; the auditor would typically not test the yield curves used by the specialist or other industry-specific data widely used in valuations unless the misstatement risk warrants such scrutiny (e.g., a complex derivative transaction with more judgment involved in selecting the models to use).

Auditor’s specialists

Alternatives for revising standards

We are supportive of creating a separate standard for the use of auditor’s specialists that retains AU 336’s existing requirements with certain enhancements, such as aligning with the PCAOB’s risk assessment standards. We believe this will enable the staff to adequately address the differences in requirements when using an auditor’s employed specialist as opposed to an auditor’s engaged specialist. However, we caution against being too prescriptive in the requirements and encourage the staff to retain a principles-based construct. As noted above, prescriptive requirements around matters such as communications and other potential requirements may be viewed as not scalable and result in additional effort without a commensurate benefit to audit quality.

Auditors currently apply two standards (AU-C Section 220 and AU-C Section 620) when performing an audit under AICPA standards, with no significant operational issues; therefore, we don’t believe it would be burdensome to the profession to apply two standards under PCAOB standards. We also believe that the definitions found in US GAAS make it clear that an auditor’s employed specialist is a part of the engagement team. Further, we encourage the staff to consider the requirements of AU-C Section 620 as we believe it adequately guides the auditor through applying procedures when using the work of employed and engaged specialists.

We foresee considerable operational issues with extending AS 10 to an auditor’s engaged specialist and believe the concerns cited by the staff on page 29 of the Consultation Paper outweigh any potential benefit of this alternative. Therefore, we do not support this approach. Alternatively, we would be supportive of enhanced guidance to auditors, such as suggested inquiries to prompt more consistent assessments of the specialist’s competence and objectivity. See additional comments regarding assessing objectivity of engaged specialists below.

Potential amendments

Overall, we are supportive of enhancing the requirements for using the work of auditor’s specialists and providing auditors enhanced guidance that could result in addressing the quality

issues noted in the Consultation Paper. We reiterate the need to focus on areas that are specific to enhancing quality in addressing the key areas that address financial statement misstatement risks. We also reiterate the need for any amendments to allow (and direct) the auditor to apply judgment as to the extent of work necessary in evaluating a specialist's knowledge or skill based on risk assessment and other audit procedures performed.

With regard to the potential changes in communications with the specialist, we agree that greater clarity in the standard could promote better communication between the audit team and its specialists. We do note, however, that certain aspects of the proposal, such as the need to document the nature and timing of communications (page 38 of the Consultation Paper), is overly prescriptive and may hinder rather than help the communication process. We suggest that perhaps revising the context for certain of those communications could result in enhancing the auditor's understanding of the specialist's conclusions. For example, including guidance related to the need for the auditor to discuss potential negative evidence noted by the specialist and how the specialist assessed the potential impact of that negative evidence could enhance the quality of the auditor's consideration of that evidence.

Furthermore, we note that the Consultation Paper suggests that the agreement between the auditor and the auditor's specialist would have to be evidenced in writing, and the corresponding footnote 74 on page 38 clarifies that the evidence could be in the form of "planning memoranda, separate memoranda, audit programs, or other related workpapers." We believe this is important application guidance since auditors could infer that the potential requirement would call for a formal engagement letter between the auditor and auditor's specialist, which we don't believe is the staff's intention. We encourage the staff to specifically include the footnote clarification in the potential requirement.

We note the potential requirement to evaluate whether the methods used by the specialist are in conformity with the applicable financial reporting framework. We acknowledge the auditor's responsibility to have adequate knowledge, but accounting principles generally accepted in the United States do not consistently provide the specificity necessary to make this requirement operational for many circumstances. We believe it can be a relevant factor in evaluating assumptions but only if the applicable financial reporting framework contains precise requirements. Therefore, it could be more operational if the procedure remained principle-based and details such as this were provided as application guidance for the auditor to consider, when applicable.

Objectivity

We believe the current requirements related to assessing a specialist's objectivity are appropriate. Thus, it is difficult to make a clear connection to the issue the staff is trying to address through possible revisions to these requirements. We foresee operational issues with the alternative regulatory approaches proposed in the Consultation Paper. Currently, there is no regulatory framework to require a specialist's independence or monitoring such as that found in the audit profession, and such an endeavor would require extensive collaboration with other standard-setters and regulators.

We expect that if implemented, these proposed changes would impact the availability of qualified specialists to be used by auditors as the specialists may deem the requirements too cumbersome and costly and therefore focus their practices on assisting companies directly. We also believe that the concerns cited by the staff in the Consultation Paper for both alternatives are significant, and we encourage the staff to continue to carefully consider these as this project continues.

Definitions

We are supportive of the proposed definitions of specialists found on page 34 of the Consultation Paper. We believe it is important to continue to distinguish between “employed” and “engaged” auditor’s specialists, based on the issues discussed above. While we agree with the initial views as to excluding income tax and information technology professionals from the definition of specialists, we note that for some firms, including ours, those professionals are incorporated into the audit similarly to valuation professionals. In that regard, we support further evaluation by the staff as to whether it would be appropriate to treat any of those professionals as specialist in circumstances where they are engaged, versus employed, by the auditor.

We do not believe individuals with regulatory compliance skill and knowledge should be considered specialists. Rather, they assist management in interpreting laws or regulations so that management may make the appropriate accounting determination.

We also support scoping out certain activities of third-party pricing sources from the definition of specialists as this is consistent with our recommendations in our comment letter regarding the staff’s consultation paper on auditing estimates and fair value measurements. Furthermore, we note that the proposed definition may need to be refined to address the need for the auditor to consider the nature of certain commercial information that is available for a fee. We believe this phrase could be widely interpreted and have an unintended consequence of reducing audit effort in areas of higher audit risk. We believe that there are aspects of the information provided by pricing sources that may still require an audit approach similar to that used in evaluating the work of a specialist (for example prices provided on more complex instruments). We also ask the staff to consider clarifying that this exclusion would include sources that may provide pricing or other financial information for free, such as foreign exchange prices available on certain commonly used websites.

We would be pleased to discuss our comments with you. If you have any questions, please contact Trent Gazzaway, National Managing Partner of Professional Standards, at (704) 632-6834 or Trent.Gazzaway@us.gt.com.

Sincerely,

