NOTICE: This is an unofficial transcript of the portion of the Public Company Accounting Oversight Board's Standing Advisory Group meeting on June 18, 2015 that relates to the Staff Consultation Paper, *The Auditor's Use of the Work of Specialists*. The other topics discussed during the June 18, 2015 meeting are not included in this transcript excerpt.

The Public Company Accounting Oversight Board does not certify the accuracy of this unofficial transcript, which may contain typographical or other errors or omissions. An archive of the webcast of the entire meeting can be found on the Public Company Accounting Oversight Board's website at: http://pcaobus.org/News/Webcasts/Pages/06182015_SAG.aspx.

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

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STANDING ADVISORY GROUP

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MEETING

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THURSDAY
JUNE 18, 2015

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The Standing Advisory Group met in the Federal Hall of the Washington Plaza Hotel, 10 Thomas Circle NW, Washington, DC, at 8:30 p.m., Martin Baumann, Standing Advisory Group Chairman, presiding.

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MR. BAUMANN: So we're ready to move to our next section of the discussion, and that is addressing the consultation paper that we issued and sent to SAG members about three weeks ago on the auditor's use of the work of specialists.

There are a number of slides that were in your package that were sent to you that provided some background at a high level about existing standards. In the interest of time I'm not going to go through those. And that material is just a summary, if you will, of what was in the consultation paper on existing standards. But we're going to move directly to the panel discussions and turn it over to Greg Scates and team to do that.

First thing I'd like to say though is the technical people have asked if everybody could please make sure that they speak directly into the microphones for the benefit of everybody, both here and listening. Thank you.

MR. SCATES: Thanks, Marty. First I'll give the disclaimer that the views expressed by the presenters are their own personal views and not necessarily those of the PCAOB, members of the Board, or the PCAOB staff.

The agenda for using the work of a specialist, this morning we will have a panel to discuss the company's specialist. And we'll run to around noon or a little bit after noon. You'll have a break for lunch and then after lunch we'll have our second panel that will discuss the auditor's specialist.

MR. BAUMANN: I'll just add the panel won't run until noon. The discussion will run to noon.

MR. SCATES: What we'd like to do with this panel -- this panel again is focused on the company's specialist, how they use the work of a company's specialist, how the specialist performs that work, then how the auditor evaluates the company's specialist as well as the findings of the specialist. So that's the focus again of the panelists' remarks.

And now what I'd like to do is introduce our panel for the discussion of the company's specialist. First, we have Loretta Cangialosi. She is a member of our Standing Advisory Group and is Senior Vice President and Controller of Pfizer, a Fortune 50 biopharmaceutical company.

Next to Loretta is Jouky Chang. Jouky is a managing director in the Washington, D.C. office of Duff

& Phelps, a global valuation and corporate financial advisor. Jouky is a member of the Valuation Advisory Services Practice.

Next we have Ken Lining. Ken is a consulting actuary in the Chicago office of Aon Hewitt, a global talent, retirement, and health solutions provider.

And then next to Ken is Wendy Stevens. Wendy is a partner in the registered accounting firm of WeiserMazars and is in charge of the firm's quality assurance.

What I'd like to do is for -- they will provide their remarks. And then if you'll hold your tent cards until after the remarks, then we'll enter into a dialogue. So I'd like to start our remarks with Loretta.

MS. CANGIALOSI: Good morning and thank you for giving me the opportunity to discuss this important topic with the SAG.

I am going to cover the use of specialists from the financial statement preparer perspective, hopefully to provide you with some insight into how preparers interact with their specialists and what our interactions are with our auditor specialists.

We are actively engaged in discussions with the specialists we hire. I want you to just have a little background. We are a very large company. We had revenues of 49.6 billion last year. Our assets are 169 billion. When we get to kind of things that would come under fair value and valuation measures, we had financial assets at a fair value of about 44 billion, intangible assets of 35 billion, goodwill of 42 billion, and employee benefit obligations of 10 billion. So we have lots of fair value flowing through and measures, financial measures.

So we actually have pretty routinely the specialists and valuation consultants primarily for our intangibles, goodwill, actuaries for the employee benefit plans, and then third party pricing services, which is really for our financial instruments.

I'm going to make this statement. Don't know whether other companies should feel the same way, but I will make this statement because in all cases Pfizer management accepts responsibility for the preparation and the fair presentation of our financial statements, and Pfizer management takes ownership of the amounts and values developed in consultation with our third party specialists. So this is not a throw-it-over-the-wall exercise where you employ a specialist and you never talk to them.

In connection with our annual external audit process we routinely interact with specialists employed by our audit firm. We don't engage those specialists.

Our auditor uses specialists employed by their own firm; so if you have looked at the diagram, that would be Specialist No. 1, to assist with auditing the work performed by specialists employed or engaged by our company, who are Specialists 3 and 4 in the diagram. My comments today will be limited to the use of our specialists in the valuation of non-financial assets, reporting units and businesses.

The first thing we've been asked to address is how do we assess the specialist's skill and knowledge? Well, when hiring a specialist, obviously we will review their qualifications, not only their firm qualifications, but of the professionals, the qualifications of the professionals who they intend to have perform the work on our engagement.

My apologies to Jouky, but I must confess that we tend to engage valuation specialists at large public accounting firms that do not perform our audit engagement for two main reasons: One, they're credentialed in the area and they serve as specialists to auditors in their respective firms. That means that they have an understanding of U.S. GAAP and what it requires and how those valuations are different than, different kinds of valuations for instance, a valuation that might be done in assessing whether to purchase a business, very different than this.

Two, we have used their services for many years, so we tend to use the same group. We're well acquainted with their methods and they are well acquainted with how we work. This ensures that our specialists will use only generally accepted valuation methodologies and have the global reach that we need when we do global transactions and that there's an appropriate application of U.S. GAAP valuation principles. So those are the FAS -- sorry, I don't know the ASC, but FAS 157 concepts.

During the procurement process and at the initiation of each engagement we hold discussions with our valuation specialists: the specific facts and circumstances surrounding the engagement, the particular issues that we believe will need to be addressed. For example, the unit of account versus the unit of valuation issues, unique assets or liabilities that we might have, or think we have.

We look at the staffing plan to ensure that the expertise and experience of the engagement team members are well matched to the expected issues, and the existence of alternative approaches and methodologies. So while we look at credentials, we also try to understand do they have a robust understanding of our industry, the pharmaceutical industry, because it does have very specific issues with valuing these kinds of assets, intangible assets.

And we also look at do they understand the life cycle of pharmaceutical products? Because most of these assets that we are attempting to value are constructed based on 10 to 20-year forecasts into the future. So this is a -- I have to say it's a subjective methodology. You have to come up with a forecast on something that you don't know. And as I've stated many times, the only thing I know about a 20-year forecast right now is it will be wrong. There is no way. I don't have a crystal ball.

Do they understand things like the probability of technical and regulatory success? We call it PTRS in the industry. That's quite important when selecting discount rates and understanding. So there's a lot that goes on in attempting to evaluate them.

I've been asked about what controls we have in place around the work of a specialist and conflict of interest issues. My organization, the controller's organization, actually is responsible for the review of all inputs provided to the valuation specialists, our specialists. And we ensure that other functions within our company that provide inputs: long-range forecasts, working capital assumptions, have the proper documentation and support for those inputs.

I want to be clear that my group is actually the neutral zone. We have no bias one way or another. We are not the business development people. We don't have to prove that the deal is great. And we are not the business people who might have to live with the results of those valuations subsequently. So our only view is to try to get to a right number.

We hold discussions with our valuation specialists and the different colleagues who are providing inputs. Lots of questions are asked. So you get together the people with the professional specialty with the people with the data. Make sure that everybody understands what the data means.

We discuss with the valuation specialists the methodologies, approaches, the application of certain inputs to ensure that our company is using consistent methodologies and approaches in our valuation efforts of the same nature. We review the outputs of the valuation specialists' work for reasonableness.

As far as conflicts of interest, we do consider whether the firm may have conflicts of interest as a result of any other work that they might be doing within Pfizer. Again, we don't drive to any result. We just try to understand what the inputs are, what the outputs are and get to a number that is reasonable.

Because we're getting to a point estimate in a process where there is an inherent likelihood that there is a range of reasonable amounts because of the 20-year forecast, discount rates and many, many assumptions, like I said, the probability of technical success, Pfizer scientists may evaluate that differently than Bristol-Myers scientists might. So you could come up with different numbers. And we just try to understand if there are biases, what the basis of changes are in forecasts so that we better understand and can reconcile those views.

I've been asked to address what do we do with the specialists' work? Okay, once the work is complete and we have reviewed the outputs from our own specialists, we review the completed model, the outputs, methodologies. We reach out to both the valuation specialist and our internal colleagues responsible for the inputs to resolve any questions and ensure that we have the proper documentation. So documentation is very important in this exercise because you're going to live with these values for a long time.

We ensure consistency, as I said. To further test the outputs produced we discuss the outputs with the valuation specialists that we employ and ask that sensitivity analyses be performed on critical assumptions so that we can understand what changes in discount rates do and how sensitive they are to these factors.

Finally when the work of the valuation specialist has a significant impact on our financial statements; like if we did a multi-billion dollar acquisition, the type of work performed is a non-recurring nature, we will receive active or written confirmation from the various functions in our company that own the assets and liabilities valued that there is agreement throughout the company that the final inputs and outputs are reasonable and reflect the best information. There's a lot that goes on.

We have also been asked to address question 6B in the paper. Just for a reminder, they asked whether figure 1 in section 2A accurately describes it and if it's inclusive. We believe the list is inclusive of the main activities where an auditor uses the work of a company specialist. Again, our accounting firm uses their own internally-employed valuation and actuarial specialists for all except very small transactions where they will use the work of our specialists and review it.

We've been asked on question 8 -- this is --

MR. SCATES: No, Loretta, why don't we move on to the next one maybe?

MS. CANGIALOSI: Okay.

MR. SCATES: Okay. Yes.

MS. CANGIALOSI: Okay. Fine.

MR. SCATES: And some of those we can respond to with the questions.

MS. CANGIALOSI: Very good.

MR. SCATES: Okay. And next we have Jouky Chang. The rest of the panelists, if you can, keep your comments to about five to seven minutes, your remarks. Then we'll move on.

Jouky?

MR. CHANG: Great. Thank you, Greg, and thank you for having me here today.

So, I'll take this opportunity to quickly outline the processes that we at Duff & Phelps have put together for the successful execution of the thousands of valuation engagements that we perform each year.

And before I do so, though, I thought I'd take a minute to kind of share with you a little bit about who we are and how we are organized. We're a global valuation and corporate finance advisory firm. We have over 2,000 professionals around the world in more than 70 offices. In 2014 we performed more than 7,500 engagements for 3,000 clients of which over 40 percent were S&P 500 and 80 percent of the largest hedge funds and private equity funds. We are, we believe, one of, if not the largest provider of independent valuation services.

Now, our professionals possess skills in a broad range of expertise in areas of valuation advisory, corporate finance, dispute and legal management consulting, compliance and regulatory consulting and tax services. As Greg mentioned, valuation advisory is the unit that I reside in and it is also our core business.

Now valuation advisory includes traditional corporate valuation products such as purchase price allocations, goodwill and intangible asset impairments and tax evaluations. It also includes alternative asset advisory, real estate valuations, and fixed asset management and insurance solutions.

So how do we ensure then that each engagement is executed successfully with appropriate rigor? Well, our process starts with a cross-functional organization structure. First, our industry program focuses our efforts into seven industry verticals each of which is led by a seasoned managing director. The industry leader's role is to ensure that we bring together teams that match the particular needs of our clients and that understands their business, their drivers of value and the issues that they face.

Second is the involvement of our product line leaders in ensuring best practices are utilized by the engagement teams. The product leaders and the entire valuation advisory practice are supported by our Office of Professional Practice, which we call OPP. And OPP is our version of the National Offices of the Public Accounting Firms.

Now, OPP is comprised of senior level professionals that support engagement teams on a myriad of technical valuation issues. Members of OPP also serve, observe and/or advise regulators and standard-setting bodies on valuation issues and best practices. Further, the office is responsible for the development of training materials for our staff, as well as the publication of various technical titles.

We have also designed systems and procedures to maintain the independence and objectivity, to identify potential conflicts and protect confidentiality. For example, our Compliance Department oversees the personal investment policy that restricts trading the securities of publicly listed clients and prospects of Duff & Phelps. It also manages the information barriers that restrict access to and maintain protection of client data. And administers the document retention policy to ensure adequate record keeping of all engagements.

And our Office of Risk Management identifies, evaluates, and mitigates financial, reputational, and regulatory risk that is inherent in our day-to-day operations. Specifically ORM identifies and evaluates engagement risk, promulgates and implements related policies and procedures, and assesses compliance with its directives.

At the engagement level each engagement is led by an engagement managing director that is responsible for all aspects of the engagement. A concurring MD with the requisite industry and technical experience performs important oversight duties throughout the engagement.

Now in the context of an M&A transaction where we assist management with the acquisition method of accounting for business combinations, this would be a multi-discipline team most often comprised of professionals that specialize in valuations of business interests and intangible assets, real property, and personal property. For transactions that involve complex securities and contingent consideration arrangements our in-house derivatives and financial engineering specialists would also be part of the engagement team.

The team will then develop and execute a work plan that befits the project requirements. The work plan for a purchase price allocation engagement would include elements that Loretta has already covered in some extent. It includes meetings with management to understand the purchase consideration that was paid, the rationale for the acquisition, the important attributes of the transaction. All of these will facilitate the identification of the assets and liabilities that may require valuation and a clear delineation and definition of the scope and responsibilities. Meetings with the audit team to ensure agreement on the scope of services and the evaluation approaches and procedures to be employed, meetings with leaders or representatives of the business units to discuss the engagement process, timing, involvement of personnel, and other project management issues and hosting weekly status calls with appropriate company and audit team personnel to review engagement progress and address any challenges and obstacles that have come along the way.

And during the course of our work we will have significant interaction with the company's finance, accounting, and tax departments. In addition, we will also meet with personnel from corporate development, sales and marketing, research and development, operations and maintenance, and investor relations. These interviews allow us to better appreciate the attributes of the subject assets and liabilities and assess the relevance of the information provided by management. That assessment is also informed by our research into market expectations for the subject assets and liabilities. That is to say, we will independently test the reasonableness of management-provided projections and assumptions against relevant market data and our industry experience.

As the team performs the analyses there will be numerous discussions with management to vet the significant underlying assumptions. This step ensures that our team has properly interpreted the information provided by management or for management to understand the basis for the assumptions being applied. Further, it is important for management to be fully informed as to a valuation process and conclusions so they can take appropriate ownership and responsibility for the preparation of their financial statements.

Let me turn a little bit now lastly, to our quality control process. The quality control process at Duff & Phelps is imbedded into our overall work plan. It starts with the careful selection of key personnel with a need of product and market disciplines that understand not only the subject assets or liabilities, but also the appropriate methods and market factors to take into consideration in their work.

During the project execution phase we use industry best practice guides as a primary reference to maintain the consistency and quality of our valuations. Further, we will model varying scenarios and alternative assumptions to assess sensitivities and key valuation parameters.

Our executive review process by MDs and directors pays close attention to market comparable intelligence, unique asset or liability attributes, and the sensitivities that are modeled by our colleagues before forming their tentative conclusions. The models are also subject to at least one full tick and tie validation by Duff & Phelps professionals that are independent of the engagement team.

Before our work product is shared with the client, an independent review of the analysis and findings is conducted by the concurring MD. The review includes an assessment of work paper defensibility, comparability to and consistency with other engagement work products, an assessment of the market conditions considered, and the uniqueness of the asset or liability.

A work product is then released to and reviewed by the company and its audit team. The work product is presented in the form of a written report accompanied by supporting exhibits. Our experience shows that the combination of auditor involvement at the onset and throughout the engagement, the contents of the written report and the exhibits, and our responses to the auditor's queries has provided auditors with sufficient basis upon which to sign off on our work.

I've probably exceeded my allotted time, but let me just note that our work with alternative asset managers follows similar processes as we validate management's estimates of fair value.

So, I hope this overview has been informative to you on the role of a company specialist. The breadth of practice demonstrates the assistance we provide to companies as they seek to obtain best practice valuation assistance and we look forward to the discussions that follows.

MR. CHANG: Thank you, Jouky. Now, let's turn to Ken Lining.

MR. LINING: Thank you, Greg, and I appreciate the opportunity to be here in front of this distinguished group today to talk about the role of the actuary as a company's specialist.

So I've been in this profession now for over 30 years. I'm a member of the American Academy of Actuaries, which subjects me to certain continuing education requirements, and also we have a discipline structure set up for certain types of dealings.

The role of an actuary really can be summarized I think as a business professional who measures risk. You've heard -- my colleague here has mentioned employee benefit plans. So, we primarily, in the pension area is calculate what the liabilities are that the company, you know, must, first of all fund, and then, second of all, record on their balance sheets and annual expense.

So, you know, we're working with liabilities. We're using mathematical and finance principles to make these calculations primarily free of interest and what we call life contingencies. And then we make these calculations in accordance with applicable laws, so on the funding side in the U.S., we follow the Internal Revenue Service ERISA requirements. On the accounting side, we're looking to the FASB. And if we're making international calculations, the IASB to make those calculations. In general, we are specialists engaged by the company, so we're independent and objective.

So, my outline is really is three points. No. 1, the work that we perform; No. 2, the education, skills, and quality controls; and then No. 3, our role as a company's specialist.

So, as you probably know, there are many types of actuaries. There's life insurance actuaries, property and casualty actuaries, health benefit actuaries. And then what I do is in the pension and post-retirement. So it'd be defined benefit pension plans, what are called retiree medical and life insurance plans that pay those types of benefits to folks after they have retired from a company. We perform a very wide range of work, and we have many stakeholders that are involved in the products that we deliver.

In terms of education, there's a lot of educational requirements: skills, certifications, ongoing continuing education requirements.

In terms of quality control, my experience is that, you know, my firm and all the other firms I've worked for in my career take this very, very seriously. We do our work, check our work, have it reviewed. And then in working for different companies, we are typically retained to do the types of calculations that require our special knowledge and skill. And of course in the course of our work we also do our best to stay alert for potential conflicts of interest.

So go next slide. So, a little bit more on the work that we perform. Actuaries in terms of myself, for example, we're under the Joint Board with ERISA, which is the Department of the Treasury, which then gives us the ability to make the calculations regarding the funding, the cash funding the companies have to make for their plans. So they have to make annual filings via Form 5500. We certify to the contributions and to those calculations.

Secondly, we make the accounting calculations that are needed for balance sheet disclosure and for income statement expense. These are reviewed by a lot of different stakeholders: stock and bond holders, regulators, rating agencies. And then also there are many other types of work that actuaries perform that are not necessarily as -- this group may not be as interested in those. For example, things like certain benefit calculations, non-discrimination testing requirements. But there is a wide range of things that we do perform.

One of the things I wanted to point out was that we typically do get involved with some of the corporate transactions: mergers and acquisitions, due diligence. You've already many of our colleagues have mentioned things like purchase accounting and business combinations. And we are typically with those types of things as well, those types of calculations.

Regarding education and skills, it's a long road. Most actuaries; not all, but most have college degrees in areas like actuarial science, mathematics, computer science, probability and statistics. Then there is ongoing work experience that's required to be performed under a supervising actuary. In addition, I mentioned the continuing education requirements. We have to be qualified to issue what's called a Statement of Actuarial Opinion, which requires annual certification.

Our work is peer-reviewed by other actuaries including perhaps some committees when we're perhaps outside of a guideline on a particular assumption. So in general we take our work very seriously and do our best to perform both on the behalf of the participants, the companies, and then the other interested parties that are stakeholders.

So when we get to our role as a company's specialist, as I mentioned, we're performing the accounting calculations that govern the profit and loss statement and the balance sheet disclosure. Companies typically will select their assumptions with input from their actuaries and then concurrence from their auditors. So the actuaries will generally have to certify the results that they're providing for balance sheet disclosure purposes. Therefore, we have a responsibility to document our work, to provide reconciliations of changes and things like liabilities, assets, and also to quantify the main factors that can cause variances from year to year in the actual versus expected results.

Because we're making forward-looking assumptions, there are always going to be variances from the actual experience to the expected. And companies and other interested parties typically want to know the main drivers of those. For example, is it a discount rate change, a mortality table change? Did the assets perform better or worse than expected?

And then actuaries are considered as trusted business partners in many situations to assist companies with things like M&A, union negotiations, and other types of accounting transactions.

It is important that we maintain awareness for potential conflicts of interest. For example, I was involved a couple years ago where I had a client that was looking at an acquisition and it just happened that the actuary for the other party was also employed by the same company. So we set up a Chinese wall and provided applicable disclosures of our objectivity and independence for each of us.

To specifically comment on the questions in the staff paper, there was a question 6B, is that diagram accurate? And we think yes, qualified actuaries should be calculating the pension and OPEB obligations for companies.

If an auditor has access to models, is the access sufficiently detailed? Actuaries generally use proprietary systems, however, they will provide illustrative models to auditors if needed. The more typical situation is 8B where the auditors will review and test select items, critical assumptions, reconciliations, asset statements and those kinds of things.

Is it appropriate for the auditor to consider the knowledge; that's question 14, and experience and skill? Yes. And note that we're typically required to certify to this assumption.

Then question 15, how do auditors obtain an understanding? The company specialist actuaries will typically invest time helping the auditors understand the material effects of various assumptions, the sensitivities to the various assumption changes.

And I want to close with a comment that many of the large accounting and auditing firms will employ their in-house actuaries. So the question was raised right before the break about the auditor then having their own specialist. We find this is a very common thing to happen. So there are a lot of issues and discussion we can have around that. We can pick that up maybe in the questions.

MR. SCATES: Thank you, Ken. Now, we'll turn to Wendy.

MS. STEVENS: Okay. So, I have the dubious distinction of being the only thing before you get to ask your questions, so I will try to be as quick as possible.

I thank you to the chief auditor of the PCAOB and his staff and the PCAO Board for the opportunity to participate on this panel today. The views I express today are my own and not necessarily those of WeiserMazars, LLP, despite my frequent use of the word "we".

For those of you who are not familiar with WeiserMazars, we are an accounting and advisory firm with approximately 700 professionals and over 100 partners in the U.S. We are also an independent member firm of the Mazars Group International Network and a member of the Praxity Global Alliance of Independent Firms. We provide services to clients in a variety of industries. Currently the largest segments we serve are manufacturing and distribution and financial services. Our issuer and broker/dealer clients would be characterized as smaller businesses and primarily operate in these two segments. We must comply with the PCAOB auditing standards in performance of these engagements, and they're also subject to the applicable rules and regulations of the SEC.

At WeiserMazars we strive to have the professionals in place with the knowledge and experience to audit in these industries. We operate with a high level of focus on continuous improvement and quality. We are constantly providing training to deepen our auditor skills and their ability to audit the more complex areas of our clients' financial statements. We evaluate the performance of our partners and professionals in terms of technical depth and adherence to the firm's quality policies and procedures.

We fully support the work of the PCAOB in its efforts to enhance audit quality in order to provide investors and other financial statement users with increased transparency and financial reporting. We also appreciate very much the outreach currently taking place with regard to the use of specialists and auditing estimates and fair value measurements.

We encounter both management-employed and engaged specialists within our practice. The staff's consultation paper accurately addresses the circumstances that specialists are used. We compiled this list in terms of frequency. And I'm not going to read the list.

So how do we address use of a company specialist? During the planning phase of an engagement, among other things, we identify risks and assess whether these risks could result in material misstatement of the financial statements. As it relates to accounting estimates, this consideration includes but is not limited to the nature, method of computation, controls in place, who prepared the estimate, as well as complexity, subjectivity, and uncertainty inherent in the results. Our initial planned audit response is designed based on the synthesis of all this information and the procedures are determined based on the significance of the risks identified. This includes preparer risk.

Specifically, if a specialist is involved, we consider the relationship of the specialist to the client, the qualifications -- and now that you both talked about quality control, we might actually ask those questions in the future, because I think they are critical as to how we actually would use the specialist results -- the methods used in the current year and as compared to the prior year, the objectives, scope, and assumptions used, and our ability to test the source data. Our audit response would be altered if we are not satisfied with the responses and the results either in planning, during, or when we are concluding our audit.

Our application of the existing use of specialist standards sometimes does result in more rigorous procedures when our evaluation of risk warrants a more extended approach. We do however recognize there is room for improvement in the current auditing standards that address the use of specialists.

And I do want to make a point about management and audit committees. They should continue to have the ultimate responsibility for accuracy and reliability of estimates used in financial reporting. Auditors are required to come to certain conclusions with regard to the assertions underlying the financial statements, so any revisions should not remove or change where the responsibilities lie. Revisions to the existing standards and complementary guidance and/or FAQs should avoid any unintended consequences that would limit responsibility of any of these parties or disproportionately move the responsibility to the auditor.

Limiting the ability to use auditor's judgment to rely on a company specialist may not result in measurable improvement to audit quality, but will likely result in additional cost. Taking the judgment away from auditors may in fact also have the unintentional consequence of reducing the focus and tenacity by which auditors and possibly management and/or the audit committee challenge the most complicated and risky computations. We believe there may be cases where recomputation by another specialist is required, but view this to be subject to the auditing process in evaluation of risk, appropriate audit response, and evaluation of the relevance and reliability of audit evidence.

In closing, it should be clear we support improvement in the current principle-based standard for use as specialists. We recommend clarity in the definition of specialist, greater alignment with other existing standards in use by auditors and PCAOB guidance and/or FAQs issued to support effective implementation of the revised standard. Thank you.

MR. SCATES: Thank you, Wendy. And thank you, all the panelists.

Before we get into the discussion and questions of panelists, I'd also like to remind the SAG members that we had two alternatives that were discussed in the consultation paper. The first alternative with respect to using the work of a company's specialist was with respect to should we amend 336? And when we say "amend," it would be removing certain provisions that we consider to be limiting the auditor's responsibilities.

The second alternative would be to completely rescind 336, and then this would require the auditor to evaluate the evidence that's provided by the company's specialist just like the evidence that's provided by others within the company.

So those are the two alternatives that are discussed in the paper, we'd like to get your views on that as well as other questions you have of the panelists. So I'd like to open it up now for discussion among the members of the Standing Advisory Group if you have questions of the panelists or have comments on these two alternatives.

MR. BAUMANN: Jeremy Perler?

MR. PERLER: Thanks. I was interested to read all this, and thank you for all the comments. I mean, the one question that stuck out in my mind was why would auditors cede the responsibility over appropriateness and reasonableness on any very sensitive estimates, particularly the most sensitive estimates? I understand the logistics behind what goes on now, but I was in reading it, I seemed to be in favor of Alternative 2 and just bring that responsibility over to the auditors.

MR. BAUMANN: Can you expand on that a little bit, Jeremy?

MR. PERLER: The financial statements are full of -- I mean, every line in the financial statement is an estimate. Depreciation is an easy one. Useful life is an easy estimate, and you can look historically. But estimates on future -- on valuation of asset and liabilities are based on future variables that I recognize need specialists to opine on. But particularly in the case of a company engaged or employed specialists for the auditor to not have significant judgment on the reasonableness of it, I think that there is a significant amount of risk of material misstatement in the process.

MR. BAUMANN: Thanks. Sri Ramamoorti?

MR. RAMAMOORTI: I appreciated Wendy's question at the end about seeking clarity on the definition of who a specialist is. And it has always bothered me that beyond the fact that the international standards would offer them as experts and we in the U.S. tend to call them specialists. There is this fundamental question of we need to know who is hiring whom for what purpose.

And so, from the academic literature on expertise, we talk about two types of experts. There are substantive experts, and there are normative experts. So substantive experts are very goal-oriented and domain-specific and applications-relevant. Normative experts are subject matter experts and they're more process-oriented. And what that leads to is an example that will probably clarify what I'm trying to say here.

So you could have technology for tax accounting where tax accounting is the substantive domain and technology is the helper or the specialist in the way we're using it. But when you talk about tax accounting for technology, now it is technology that's the goal, that's the domain, and the expert or the specialist is the tax accountant.

So the problem I'm having with the definition right now of specialist is that it says these are folks who have expertise outside of accounting and auditing, and that's not really true. Because there could be accountants and auditors who could serve in the capacity of specialists where the domain is other than accounting and auditing.

MR. BAUMANN: Maybe you could expand a little bit more on that point you're trying to make. Is it that you want to include other parties in the list of specialists?

MR. RAMAMOORTI: No, no, no, no. All I'm saying is that we need to understand what kind of expertise is being called for and who is serving whom. So in the sense who is the core? Who is the goal here for which we are doing this? So to the extent we're talking about financial reporting being the domain, anything else like, you know, statistics or computers or, you know, valuation, anything outside, sure, you know, they all are the normative experts because they're all functional process-oriented, et cetera.

But where you have technology, let's say, as the domain for which tax accounting is the specialist, then when Google would hire a tax accounting consultant to do some of their kind of valuations or whatever from a tax perspective, the Google folks are the substantive folks and the tax accountants are the specialists because the domain has changed. It's not accounting. And so to the extent we say in the standard that this is specialists as in people who are outside of accounting and auditing, that's not technically correct because there are other applications in which accountants and auditors could be the specialists.

MR. BAUMANN: Okay. Thank you very much for that insight.

Liz Murrall?

MS. MURRALL: Thank you, Marty. In considering whether or not auditors could rely on the work of company specialists, the auditor is to gather adequate audit evidence to form an opinion on the financial statements. And I think as investors we do have concerns that the engagement relationship with the company, with the company specialist, whether that specialist is engaged or employed, does create a threat to their independence.

And I actually agree with the staff paper which says that auditors should evaluate in the same way as other information provided to the company. I think it's very important to distinguish between auditors' employed and engaged specialists and companies' employed and engaged specialists. And in particular, in following that model it's also consistent internationally with ISA 620. And I think that's very important investors invest internationally, and companies are international and can two listings.

MR. BAUMANN: I think Guy teed up a question before lunch, and Jeremy's comment and your comment follow up on that, which is the question really was does the auditor have to understand the models and methods that were used by this company specialist? And I think we can go back to the, maybe to Wendy or to the group here to talk about how proprietary their work is.

But I think the point that's being made is if some of their work is proprietary and, there's a black box that the auditor's not looking into, you're questioning is that acceptable for the auditor, therefore, to accept the results of that work as audit evidence if the auditor doesn't really understand maybe what was calculated inside that black box.

Is that the essence of your question, and yours, Jeremy, and yours earlier, Guy?

MR. JUBB: Yes, with the addition in my question related also to where it was relating to the black box used in a subsidiary company that may not have been audited by the lead auditor.

MR. BAUMANN: So I think there's common questions there that maybe we can give back to the panel and to Wendy in terms of an auditor using that. I think Doug's card's up, but if you don't mind, I'm going to go to Jeanette

Franzel and ask Jeanette.

MS. FRANZEL: Thanks, Marty. I do have a follow-up question for Wendy, if you could elaborate a bit on something you brought up. You mentioned that, based on risk and other circumstances, you may make a determination that you need your own auditor's specialist to go out and review what management specialists did. Could you elaborate a little bit more on what kind of a scenario, you know, that would represent? And then what procedures would your specialist do then to review management specialists' work?

MS. STEVENS: Do you want me --- can I answer it now? Yes? Okay, because I'm still a little confused on the first couple of questions that were asked, so I'll answer Jeanette's question first.

When we go through the planning process; and so I will use what Loretta was talking about and all of the things that she does, we will understand the process that takes place. And I'm going to specifically narrow it down to let's say business combinations so that we can be talking about a specific example.

So we will go through with the client what they did in terms of gathering the data, what their part of it was, what the specialist's part of it was. There's a big difference between what Loretta describes and what she owns and what her input into the process is; and I mean you and your group, versus when we -- and we encounter this often with a smaller company where they basically just off -- and now I'm talking about they've hired a specialist and they have provided all the information.

So there's not a lot of -- I won't use the word "independence," because that's probably overused, and that's not the right word to use, but they don't own the knowledge, internally, before they go hire the specialist. So we would be much more skeptical of the objectivity. Okay? So there's one circumstance.

Another circumstance in that same scenario is we have an unsophisticated client and we perhaps don't have them hiring Duff & Phelps. It's a valuation expert that was chosen for the least cost, because that's usually a red flag to us that maybe they don't possess the qualifications. And, you know, the point I made earlier about the quality control at the specialists had come up when we were vetting it internally. That would be quite important to us. So, we may ask that question in the future.

But in the past, although we didn't specifically ask that question, I would say if we were skeptical on the quality, we won't spend a lot more time trying to figure out if the specialist -- we do have the in-house expertise, and we would probably pair them up with the specialist and the client. And he may or may not rerun it. The inputs also become very critical, and that's where the sensitivity analysis comes in. We may suggest that the specialist do it, or we may do it.

But there's a number of circumstances. And again it comes down to your overall judgment, the materiality, how risky the range is. But that's a couple of examples of where we might hire our own specialist or use somebody in the firm.

The other questions about the expectation gap, I want to say, of what the auditor does versus what the specialist does, from my perspective when I was an auditor and the partner signing the opinion, there would not be a circumstance where I would off-load my responsibility to understand the risks inherent in an estimate from an auditing perspective to a specialist because I was comfortable with their competence and some ticking and tying of inputs and outputs. To me, and it falls under other standards, but it is not different from the tax provision.

Now that I'm on the other side in a compliance role, I have had circumstances where I've had issues or questions on the tax provision and the partner might say to me, which is unacceptable, well, that's not my responsibility. It's the responsibility of the tax partner. And I will tell you the engagement team still has ultimate responsibility for understanding the assertions within the financial statements. And from an auditor's perspective, what's most important is risk ranking them. So if the area of the estimate that a specialist was used is not that inherently risky, we wouldn't spend the same amount of time as if there's a wide range of possible outcomes. So, I hope that addressed some of the questions.

MR. BAUMANN: Let me just follow up on that, if I may. What you're saying, I think, was; and it sounds good, that you, as the audit partner, conclude that the assumptions that the management specialist used are reasonable and you conclude that the methods and their calculation and their models -- you know enough about it so you've concluded that's reasonable so you can then evaluate that estimate. I think that's what you've said.

MS. STEVENS: That's correct.

MR. BAUMANN: So, and if that's the case, that's good, but I think some people here should understand that that's I believe beyond what AU 336 might require.

MS. STEVENS: Only in the circumstance that we have a judgment that we're not comfortable with what was presented to us.

And I also want to make one other comment. Based on my conversations with a lot of audit teams, we do not encounter a lot of pushback on being able to speak to the specialist or the underlying methods, assumptions, what's referred to as proprietary. We believe we've had full access to everything that we've needed to be able to come to our audit conclusions.

MR. BAUMANN: Yes, so again I would just say I think that sounds very good. And it's not bad that it's beyond AU 336, because we think AU 336 -- at least we're teeing up in this consultation paper that the auditor should audit the evidence produced by the specialist or my management in a similar way. And it sounds like you're auditing it in a similar fashion. You're gaining an understanding of methods and models, assumptions and concluding on the reasonableness of that. And that would lead me to say to meet your baseline our standards should be elevated to your baseline.

MS. STEVENS: The only difference I think in what you're saying and what I'm saying is I think we are following the standards, and I think the standards allow you to go further should the circumstances suggest. So we don't think that should be mandated. We think that only in the circumstances where we are skeptical on the results would we take it further.

MR. BAUMANN: I understand. Okay. Thank you.

I think Jay Hanson's card is up. Let me take Jay. Doug, you're definitely next.

MR. HANSON: Well, I've got a question I really want to pose to some of the auditors, and I'll let Wendy off the hook and maybe focus on a larger engagement. One of the alternatives in the staff consultation paper is treat anything you get from management the same. So I think -- and it's been a long time since I've actually been in the field as an auditor, but as a young auditor you learn how to deal with accounts receivable, for example. That you get the listing from your client. You do something to make sure the listing actually adds up to the number at the end, you reconcile it to the general ledger, you select items to test, you send confirmation letters, you test the aging, you test the accounts related to that. And so that's within the skills of an auditor.

So, in contrast; I'm going to look at Ken here, let's say that Ken's firm performed an actuarial valuation on a defined benefit pension plan covering 15,000 people at a given company. I know what I used to do when I'd get that valuation report, and I can imagine what happens today, but I'm just wondering for the major firm representatives especially if they could maybe give us a practical illustration of the difference or the types of things that would be required to do that, treat it the same as if it was that list of accounts receivable and test it in the same way that an auditor tests that list of something they do have the skill set to do, what it would actually take to essentially re-perform what Ken's firm had done on that actuarial valuation.

MR. LINING: So is this for me to answer?

MR. BAUMANN: Who wants to go first? I think he was asking some of the auditors in the audience if any of them -- Bill or Mike or Sydney or anybody wants to take the microphone.

MR. GALLAGHER: I'm happy to take a shot, and Bill can correct me if I go off track.

So, Jay, I think the way we would look at it is obviously everything is done in the context of the relative materiality and risk of the estimate, but you would look at the quality of the expert. What's their professional reputation? You'd look at potential independence factors. Are they truly coming in and independent? For example, if the company that they're doing work for is one of 10 clients or is their largest client and represents 50 percent of their billings, that's probably something that would catch our attention.

If they're one of thousands of clients and strong professional reputation and the like, independent in every other way, we would look at certainly the information provided to the expert, because it's garbage in/garbage out. I'm probably violating the rule about not talking into the microphone. And so making sure that they have the right information on which they can perform the calculations pursuant to their expertise. You would look at whether the numbers are reasonable. You'd look at the history. How close have they been in the past based upon historical information as a sense as to how accurate they've been, how good they've been.

We --- and the large firms typically -- when you're talking about actuaries, we typically have our own actuaries on staff. And so you have expert-to-expert conversations. So everybody's kind of talking the same language. I think that the issue that we're talking about; and Marty teed it up and others as well, is what does that mean in terms of going into the black box and how much detail do you get into going into the black box? And that level really depends I think on everything that I just spoke about. What's the risk? What's the history? What's the reputation and quality of the outside experts? And you could get a different answer depending on the answers to those earlier questions.

So maybe not a terribly fulfilling answer, but it depends on facts and circumstances. But hopefully that helps.

MR. HANSON: And Mike, just to clarify, were you just giving a rendition of what happens today, or your vision of, gee, if you said you have to audit the same way you audit a list of accounts receivable in the future?

MR. GALLAGHER: I think that's kind of how we look at things today, Jay, that -- and again, sliding scale based on materiality and risk, but I think that's how we would look at things today.

MR. HANSON: Yes, and I'm really kind of curious as to how much thought you've given to, gee, if this really were to change the paradigm and audit it like you do anything else, how much more work it would be to do that exercise.

MR. GALLAGHER: Yes, and I do worry a little bit about the notion that it's like anything else and it assumes that an auditor can't consider -- and maybe that's not what we're talking about here, but I would hope we're not taking it to the point where the auditor can't consider the technical expertise and independence of the expert as a factor in weighing the amount of work that the auditor would do.

MR. BAUMANN: Thank you very much for that response to Jay's good question, but it sounded a little bit almost like Wendy's answer that -- sounded very good, but it did sound also --

MR. GALLAGHER: Thank you, Marty.

(Laughter)

MR. BAUMANN: Noted for inspections, right? Sounded very good, but it also sounded potentially beyond what is simply in the book on 336, that procedures are more risk-based and in certain cases would go beyond what it says, obtain an understanding of what the specialist did. But in cases where you think the risk of material misstatement is greater, that understanding would be how reasonable are the assumptions? How reasonable are the methods and testing that by your own actuary or your on specialist in those circumstances. So your sliding scale was very risk-based, maybe more than AU 336, the existing standard, is.

But you're nodding your head, so I'm going to say Mike was saying yes.

MR. GALLAGHER: Yes, I think that's fair. And again, similar to Wendy I think that you've got enough flexibility under 336 to make those judgments.

MR. BAUMANN: Doug Maine has been -- his card's up there for a few minutes. I promised him he would be next.

MR. MAINE: Thank you, Marty. While I'm certain that the employees that are the specialists for Duff & Phelps and Aon and the accounting firms and others are professional and conscientious and qualified, in my mind it takes a real leap of faith to believe that and also to believe that they won't simply tell management what management wants to hear.

So question I have for the panelists is how would they feel about some sort of certification process? Now I know actuaries have that, but as far as I know the other ones don't. Setting aside for the moment the practicalities about who would provide the testing, how that would work and so forth, how would you feel about a certification process? Because to me as a hirer it would demonstrate a level of expertise. And also if the person failed to perform, they could lose their certifications or their license.

MR. CHANG: So I appreciate that question. And in fact the profession, there is a movement now towards moving towards trying to bring some better uniformity and consistency and in essence some form of certification to represent that.

I think you're probably --- Greg, I think you're probably going to try and raise that in the afternoon panel? Is that correct?

MR. SCATES: We will be talking about valuation specialists also with respect to when the auditor uses a specialist.

MR. BAUMANN: Yes, but I think it's a good question right now for if the auditor's going to look to management's specialist, actuaries have the broad certifications that we're talking about and peer reviews and things like that. I think Doug's question is if management's going to use specialists, and auditors are going to use that work, should the valuation specialists and other engineering specialists and others that are used be subject to certifications? Would that change the landscape and make Doug and others feel more comfortable in that area? And it sounds like you're saying there's some movement towards that, but for the valuation specialists there's not yet a certification, peer review program, things like that?

MR. CHANG: That's right. I mean, it's a conversation that's been going on for quite a few years, and a speech by Paul Beswick at the time in 2011 at the AICPA conference really kickstarted that movement, if you will. And this is a group, to my understanding, that is led by the valuation professional organizations, the various organizations that are involved here in the U.S. to really look at how can we put some structure around it, how can we put some standards and practices around it to provide that assurance. And it's my understanding that that group has met with the FASB Board has met with the SEC and has met with the PCAOB as well.

And so when I say "movement," it's trying to get there. I think as a professional we sort of recognize that the -- whether it's the voices that are louder, that looking for, that type of assurance or -- and "assurance" again might be over-using the term, but that sort of --- to give some more confidence behind what we have done to help with sort of that perception, right? Because as I described, we as a firm do have in my mind some pretty good processes in place and policies to ensure that we are in fact independent, at least from -- whether it's personal financial holdings and what not.

And then when it comes to how do we defend our work product; I think I'll leverage a little bit to what Mike's response was earlier, is we serve thousands of clients and if we can't defend our position for one client, it has a ripple effect on our ability to defend the position for another client. Right? So we really need to be able to stand on our own in terms of the conclusions we've reached is reflective of the facts and circumstances that are associated with each estimate that we provide.

MR. BAUMANN: Thanks for that response. I'm going to jump if I can to David Tweedie. He's put his card up and given your role on the International Valuation Standards Committee, and maybe you want to continue this dialogue?

MR. TWEEDIE: Thanks, Marty. I think it's very difficult now for auditors in the sense that if you look back 15 years ago the subjectivity in financial statements was much, much less than it is now. The standard setters, the accounting standard setters have tried to control that a bit. As far as intangible concerned, we don't allow you to have homegrown ones because it's very difficult to value. When it comes to business acquisitions, you've written a check and, all right, you might have fair values of intangibles, but there's a cap on it. It's almost an allocation exercise within the total amount.

Where it's got really difficult has been as we've moved more and more into financial instruments. And that's where we're going to have a lot of problems. Somebody is often saying that we should really take the financial instruments figures, the deferred tax figures and the intangibles and net them off together and then we'd only have one damn silly figure in the accounts instead of three.

And the sort of thing that you've got in financial instruments, it's easy when you've got markets. When you move into levels 2 and 3 you can have exotics. And I was listening to Loretta; and she won't be dealing too many financial instruments, but we check the credentials first. We haven't got any. These are pointy-headed whirling-eyed astrophysicists doing some of this stuff.

And there is no check on them. And that's one of the real concerns we have now.

Jouky was talking about the work that's going on mainly in business valuations to say, well, what do we do to have a credential that people recognize? In the United States there are 45 real estate organizations linked to the appraisal foundation. All have got their own qualifications. Paul Beswick was talking about five different business qualifications. And the move is now can we just bring them together to say that here is going to be a common credential. And you've got to have these entry requirements, these exams, CPD, discipline, ethics. And we're going to see a few of them hanging from trees when they get it wrong. And that's not there at the moment.

So it's very difficult to look at the credentials and see what's happening. And in financial instruments there are none. AICPA is talking about trying to do something. But then you've got to persuade the banks to get their guys in to take these credentials. And that's going to be difficult.

So I do think the auditor is in a very difficult position, because we know from looking at the evidence of some of the financial institutions that when they do these more exotic financial instruments, they're not even close to each other. And we're talking about sometimes hundred percent differences. Well, we'll never get it down to three decimal places, but we've got to get into the same ballpark.

So I think there is a move for the firms with the professional organizations. The banks are staying out of it. They quite like it the way it is. And they have proprietary information and sometimes they require the auditors not to reveal any of that to anybody else. And it's very difficult to get the comparatives in these situations.

So, I personally, and I've said it before publicly, I think we have a lacuna in financial regulation. We've got the accounting standards which say use fair value. And we pinched Bob's standard at 157. It's IFRS 13. It's the same standard. What it doesn't do is to say, okay, once you use this, what's the fair value? And now we're discovering, as we did in the crisis, that the values are miles apart.

Now, how do we start pulling that in together? And one of the things we're talking about is can we get the firms and the financial institutions and the users and the VPOs together to say, right, what's causing these differences? What can we do to try and eliminate them? But that is going to take some time to do. And I sympathize with the auditors, because you have specialists such as Ken who's coming from a recognized profession. You've got lawyers who are in -- well, I suppose it's a profession --

(Laughter)

MR. TWEEDIE: -- and the accountants. They are really identifiable. But you've got a new professions out there that haven't really found themselves yet. And that's where I think you're in real trouble, and that's where it's very, very tough for the auditor. Is it reasonable? Yes, but this one's also reasonable and they're miles apart.

MR. BAUMANN: Right. Good comments. Thanks to David.

Brian Croteau?

MR. CROTEAU: Thanks, Marty. Just quickly. Again, my own views particularly here. Again, I would certainly associate myself with Paul's remarks in this regard, and I appreciate sort of the comments here relative to the efforts that some are undertaking including the AICPA. I think this is complicated and probably going to take awhile for real progress on this. And I'm not trying to promote any particular path that they or anyone else might go down. I think it requires careful coordination with lots of different elements and valuation-type professionals.

And so my sense of it is that this isn't something that will happen overnight. And if that's the case, continuing to think about other ways to advance that more quickly or advance efforts like that more quickly or get some momentum behind it I think is personally I think is important. And again, not looking to endorse any particular approach. I think it's early, really early stages on this, but certainly I would associate myself with the remarks that Paul made.

MR. BAUMANN: Thanks. A couple of the panelists have had their cards up. I know some of the other SAG members have, too, but I think they wanted to respond potentially to some comments made. So why don't we let

Loretta and then Ken do that?

MS. CANGIALOSI: Yes, I had two comments. One is on the whole idea of some kind of certification for the valuation folks. I would absolutely support that. I mean, as I said in my remarks, we do try to go for people who understand what this exercise is all about and how it's done. I think it would be really helpful for the auditors to have that to say, okay, you know, these people have this certification that presumably they have continuing education, they're knowledgeable about the methodologies. You know, there are some whatever standard-type methodologies to be used in the U.S. GAAP valuation. I think having those things would be extremely helpful for the auditors in the amount of work that they have to do.

Second thing is I just wanted to make it clear that when our auditors come in and look at the valuations, they certainly understand the assumptions and all the rest, but they do do a re-performance. They actually take all the inputs, because they get all the flat files -- they have their own internal model that they've developed. They input them in and then they look at the outputs and then they build a bridge back to our specialists' outputs. So that's an extensive exercise.

It hasn't resulted in any major adjustments. It's really an understanding. They understand their models. The specialists understands their model. That's how they're getting that understanding of the model. But it seems like that's an awful lot of work considering that these are groups that supposedly should be using similar types of methodologies.

MR. BAUMANN: I'll just comment again that whether you think it's too much work; or maybe it is or maybe it isn't, what you said they're doing is beyond what I consider to be the minimum requirements in AU 336, which it sounds like a lot of people are saying, yes, they have to go beyond that, which I think goes to what we're raising in the consultation paper, does there need to be something stronger than AU 336? And it sounds like most auditors are often doing more than that, coming in and testing those models.

So I think Ken had his card up.

MR. LINING: Thank you. There was a comment made on page 30 of the paper that reads: "In cases where the auditor does not have the specialized knowledge or skill to perform more rigorous procedures, the auditor might need to employ or engage his own specialist." This was a comment that was raised before the break. So I'll try to make some comments here which I hope will try to tie together some of the questions here.

Generally, when we're going through a year-end audit for one of our client's plans, it's a pretty typical case that, you know, we will prepare the information, the reconciliations, the PBO asset disclosures and then send all this to the company. Typically also they want to receive it directly --- the auditors typically will also want to receive this directly from us. We will receive several follow-up questions about how did you select these assumptions? For example, discount rates, expected rates of return, mortality table.

And as we mentioned before, many of the large auditing firms also employ their own actuaries. So we typically will discuss these items through with them. In some of the cases, some of the plans I work on the benefit obligations will actually exceed the market cap of some of the companies that we work for. So there's a very large exposure. The SEC certainly is interested in making sure those numbers are correct.

We want to make sure that the auditor's specialists understand the methods, the assumptions, the data, that our reports are fully documented in terms of exactly what we're showing so that they can come back and then, you know, ask us questions about those. I don't think there's a --- in terms of testing certainly, we expect them to do some sample testing. We will typically send them things like cash flow streams and spot yield curves so they can come up with relatively similar liability and discount rate and that kind of thing.

I'm not sure it's necessary for the auditor or the specialist to actually replicate our work, but certainly to test it and become comfortable with those results. Thank you.

MR. BAUMANN: Thanks. Joan Amble, Phil Santarelli, then Bruce Webb are the cards that I have.

MS. AMBLE: Okay, thank you. I guess a couple things, and some of this I'm probably just stating the obvious, but kind of underscore what we've heard. I do think it's important that if you start first with the preparers -- and actually this would apply both to the auditors if they're engaging a specialist -- I think it's important to understand who does the engagement of the specialist in terms of the independence. And my experience has always been when you're in a company and let's say you're wanting to check how they're valuing derivatives or something in a capital transaction or goodwill or intangibles, you generally don't want that function that owns it to engage the specialist. It's much better to have an independent group, whether it's the chief accounting officer, which is what I've typically seen. Because I think having the specialist know who they're reporting to really helps in the whole independence issue, number one.

And obviously when you evaluate that you're going to look at them for their independence. And for me I don't know if it's as much as how much revenue are they bringing in, but rather do they have the backbone to give a position that may be contrary to what management might expect. And I think that's a matter of looking somebody in the eye and having a very senior person, whether it's management; and it ought to be somebody from management, but also a very senior person within the auditing profession that knows how to grill the individual to make sure that they understand that they want them to do this completely in accordance with whatever valuation model is appropriate. So that really speaks to the independence, the competency.

I think the third thing to look at is who's controlling the output. And particularly as it comes back to the company, it's one thing to have either an employee within the firm or somebody that they've engaged, but who makes the final call? If I look at pensions for example, what scares me is that I think a lot of people don't understand pensions. And quite frankly, it's not that difficult if you just take the time.

And I think that making sure that you understand who determines who's going to be moving these assumptions and whoever owns it within the company understands it as well as the auditors. I do think the auditors need to understand the -- they don't have to be a specialist, but if they engage a specialist, they need to understand the output. Because if they don't, I'm not sure -- I'm on audit committees now. I wouldn't feel very comfortable if my auditors didn't understand what the specialists had done. So to me that's bare bones minimum.

And so I guess that -- because I don't think you can abdicate the responsibility either as a preparer or an auditor.

So that being said, I guess where I'm a little bit confused is I know we've teed it up of do we want to amend or rescind 336, and I guess I'd just challenge -- and maybe I just don't have enough knowledge of the 336, but if firms are already expanding it to get to an answer that will enable them to ensure that they understand the output, they've determined independence, et cetera, and competency and control, is it a circumstance where instead of amending or rescinding, it could be an interpretation and/or an articulation of expectations or best practices? And I just throw that out there because I think maybe that's easier than amending or rescinding.

Now if we think that people going above and beyond is clearly above and beyond and it's not an interpretation of that, takes that off the table. But if it could, I think that might be an easier thing to come through.

And the last point I wanted to make was in the document; and I would see this as a best practice, if it could be, we articulate the representations that we think the specialists should make, whether they're specialists in any of the terms, whether it's the specialist within the company or somebody that the company engages or somebody that the auditor engages. Rep letters are a form of art that are already out there. A lot of people do it already. I mean, the firms get it from the CFO, the chief accounting officer, and the CEO, but quite frankly, they get it from a ton of people in the company. At least that's always been my experience.

And I'm almost wondering if the nomenclature can make something like that a little bit easier to accept as well, that you would expect that whoever that specialist is, that they would have a defined set of representations. And again, they would give that to the auditor. And because I do think having that individual understand who they're ultimately reporting to helps in really understanding what their role and responsibility is. And, gee, I didn't understand. And quite frankly, we kind of get that already today.

If you think about an estimate we haven't talked about, which can be huge, are legal liabilities. And, you know, in-house attorneys and sometimes external attorneys provide that all the time. And, you know, that's kind of a black box sometimes, too, until you really delve into it and really push how are you doing it? These are the rules, et cetera.

MR. BAUMANN: A lot of good comments. Thanks very much, Joan.

I think I said Phil was next, right?

MR. SANTARELLI: Thank you, Marty. I'd like to speak as a representative of smaller auditing firms who by extension represent smaller issuers and advocate for retention of 336 with potentially some enhancements. I've heard a lot spoken about how somehow the auditors in many cases are extending 336, or how 336 is applied. I don't necessarily agree with that. I think there exists in 336 a paragraph 12 the concept that if the auditor finds the conclusions of the specialist to be unreasonable, they can't really accept them. And in some of those cases they may have to employ their own specialist to go further.

I think some of Wendy's comments as far as the risk assessment is really an extension of what's in 12, what's in the spirit of 12. You can't really --- in many cases where you've got a company like Pfizer, what Loretta's doing with her specialists, it is not uncommon in the smaller issuer world where the ICFR over their use of their specialists is just not good enough. And auditors need to address that appropriately and in some cases challenge management to do better or in fact bring someone else, either someone they have internal to their firm or not. So I think 336 provides for that currently.

The other issue I would want to put on the table is one of the fundamental concepts in 336 that goes back to when the standard was developed is that auditors are not expected to have expertise out of auditing. Okay? They're not expected to have -- they have business sense. They understand the clients that they're auditing. But if you move to rescinding 336 and put it into the way we would audit the rest of management's information, a re-performance type scenario, I think you're now making that requirement that the firm will in fact have to have that expertise, and that becomes, in my view, fairly burdensome for the smaller firms. And whether or not the universe of people that can do this work exists to be hired or employed by the firms is an open item.

So paragraph 6 talks about that. I think we have to retain that concept that auditors have their expertise and should be savvy enough to be able to challenge the results of the use of the specialists. But something in the nature of a staff audit practice alert that we've found as a firm to be extremely helpful in going about our business with guidance on how do you evaluate the competency of the specialist, how do you test the inputs that they get from management, and considerations when evaluating the assumptions inherent in that can go a long way to improving the quality that exists when using specialists. Thank you.

MR. BAUMANN: Thanks, Phil.

Bruce Webb, and then I have Philip Johnson and David Kane.

MR. WEBB: Well, Phil stole a lot of my thunder, but -- and thank you for that. But I really want to keep my comments pretty narrow in terms of the question at hand is should we amend AU 336 or rescind it? I strongly advocate that we amend it, that we bring it at least up on par with ISA 500, 620, AU-C 500, 620, which I think are stronger standards and would address some of the deficiencies in 336 that you have identified, Marty.

As Phil says, auditors are CPAs. We're not geologists, we're not gemologists, we're not engineers. So, to do a good audit an auditor is going to need to use the work of specialists in certain situations. And you've correctly identified the four ways that a specialist can be utilized: either company- employed, company-engaged, auditor-employed, auditor-engaged. Well, there's only one of those four scenarios where the auditor has control over the specialist, and that's when it's an auditor-employed specialist.

So I think it would be a big mistake to sort of do away with the guidance on how an auditor would supervise and interact and use the work of a specialist, realizing that, you know, as the paper has pointed out that the auditor-employed specialist is subject to the supervision requirements of AS 10. And that's always been the case. So once again, I would just advocate very strongly for not throwing the baby out with the bath water.

MR. BAUMANN: Yes, but amending and elevating it to some of what we've really heard, closer to what the ISA has.

MR. WEBB: Very supportive of that, Marty.

MR. BAUMANN: I think I said Philip Johnson next and then David Kane.

MR. JOHNSON: Thanks, Marty.

MR. BAUMANN: And then Tom Selling.

MR. JOHNSON: My comments are very much on the line that we've just been talking about, of not throwing it away. I think there is definitely a time for a new standard. IAASB did ISA 620 through the Clarity Project in 2009 for basically 2010 year-ends. Fair values and the use of specialists has increased since the current PCAOB standard was issued. So I think it is important that we bring it together, but I think that a lot of what was done in ISA 620 did address some of the issues, or a lot of the issues that smaller accounting firms, smaller audit firms have. And so, I wouldn't throw out AU 336 in its entirety.

I think that when I was looking through the papers, I was in agreement with lots of what was in the papers, but it struck me that -- and as Mike said and as Wendy said, best practice has moved on. But possibly one of the areas that hasn't moved on quite as much as it should do and in line with standards generally is documentation of what is being done, particularly for the auditor-engaged rather than the auditor-employed. Because within the auditor-employed, often they're just an integral part of the audit team, particularly in very complex audits. So I think documentation, both IAASB, when they did their review and from your findings, the documentation is a weak point. So I think that what you've got detailed in on pages 37 and 38 with regard to documentation for auditor-employed is important and should be emphasized.

I have a number of comments to make, but I'll drop a note on those.

One of the things that's not --

MR. BAUMANN: Well, after lunch, we're talking more about auditors-engaged or auditors-employed, so to that extent you have time if that's your subject.

MR. JOHNSON: Okay. Okay. And so the only other point that I was rais -- and I don't know whether you're dealing with that, and that's with objectivity later on in the paper. Is that going to be this afternoon?

MR. BAUMANN: Yes. Yes.

MR. JOHNSON: Okay, that's fine.

MR. BAUMANN: David?

MR. KANE: Yes, I don't want to pile on, Marty, but

I think it is probably a good option in terms of AU 336 to up the game a little bit from the auditor perspective. I think what's in the ISAs in terms of looking at the relevance and the reasonableness of the findings, the conclusions, the contrary evidence, the methods and assumptions is being done in many cases today, not completely all, but in many.

But I think to Jay's question about how is it altogether different if you were to rescind AU 336 than from, you know, just looking at the higher-level guidance that 336 has. So I'm just thinking about like a pension plan, for example. And if I had an AR listing and a pension plan, a pension plan going down each participant, or like an OPEB, tracing that through in terms of all the potential benefits that that participant may get, tons of assumptions, lots of calculations -- and if we don't have access to that proprietary model as an auditor, and we think about testing the estimate, it feels like we've got a couple options, right?

One is looking at subsequent events, and that's generally not going to be as helpful in this circumstance. Can't really test the process anymore because we don't have access to that model as much as we would need to. So then we're going to be kind of left with generating and independent estimate. So when I just think about developing our own model that's going to be consistent with what the specialist has got and is providing to management is a heck of a lot more work than it would be of looking at the overall reasonableness of the assumptions, the methodology, and doing some corroborative calculations and some shadow calculations to make sure that what ultimately the specialist is coming up with and what management's using is in some sort of reasonable relevant range.

And maybe just one last point, too, in just thinking about this. If you were to rescind AU 336, feels like companies would have to do a lot more as well. Because for auditors to go in from an ICFR perspective and be testing all the same -- sorry, a lot more data than what the company's actually doing, and if the company's applying more like an AU 336-type model itself, I don't know if that's exactly on par, and I'm not quite sure that makes a lot of sense.

MR. BAUMANN: Good. Thanks. Very helpful

comments.

We're probably about five more minutes. We're over the time that we've allotted for the morning, but there's a lot of cards up. Try to figure out how to handle this because the content is so good that we're getting. But let's try to limit it to five more minutes. Keep your cards up if I don't call on you. And then after lunch we can continue this dialogue.

Tom Selling and then Jean Joy.

MR. SELLING: I also agree that AU 336 should set forth situations where the auditor's responsibilities can be limited, but in principle I believe a necessary condition should be that the specialist is independent from management. If that's the case, then the auditor's work can be efficiently limited to examining whether, for example, following sort of David Tweedie's example of physicist, that the specialist is qualified to perform the task, that the auditor can verify that the expert is independent in appearance, it can verify inputs that are capable of verification, it tests calculations. However, the auditor then cedes the judgmental issues to the experts. The auditor shouldn't even be expected to perform a reasonableness evaluation of that judgment.

But of course what I just described and Doug Maine alluded to already is that independence and certification standards are key. So I would hazard that the critical path to this discussion lies with parallel guidance similar to Article 2 of Regulation S-X that should be applied to experts. Fortunately, I'm sitting right here next to Brian, and I think we should be able to draft the needed amendments over the lunch break --

(Laughter)

MR. SELLING: -- and we'll get back to you then.

MR. BAUMANN: That was going to be my follow-on question, is what independence rules did you have in mind that all these specialist organizations should follow? I did hear one of the -- Ken, you may have used this term. At times with our clients we want to be trusted business partners, or we are trusted business partners. Would that be the same client that you might be doing an actuarial calculation for, that you're sometimes also a trusted business partner. And that might not jibe with the independence.

MR. LINING: So, I think, you know, we will have a high degree, a track record of accuracy and objectivity with the client so that when they want an objective business opinion about something, they will ask us.

MR. BAUMANN: Thank you.

MR. SELLING: Just last 10 seconds, but lacking that I believe that the information that comes from specialists should be seen as to be coming from management. The auditing standards already say that it's management's responsibilities for the estimates, and I believe that any non-independent source should be treated the same whether it comes from management or whether it's from specialists the management's retained.

MR. BAUMANN: All right. So, we're going to have Jean Joy, Jeremy Perler, and Bill Platt, and then we'll have to call it for lunch. Thanks.

MS. JOY: Thank you, Marty. I don't want to reiterate the comments that I agree with that Phil and Bruce previously mentioned, and in particular with regard to some of the smaller firm issues, because there is a lot of reliance on AU 336 and its application. And I think in practice it has been a very workable standard and has worked for most. Obviously, enhancements would be supported wherever deemed appropriate, particularly with independence and objectivity, and maybe further guidance on how one gains an understanding of the methods and assumptions.

But having said that, I do think that the use of specialists is really key to audit quality, and to try to have the auditors assume a specialist mentality, you know, that's really not where we are, but the use of a specialist is key to audit quality. And our ability to assess the work of a specialist I think is also key.

So, if you have a situation where you don't think you, as an auditor, could reasonably assess the results of a specialist, you would be engaging your own or on a much broader scale depending on the significance of the issues. I think you'd have to look at that with client acceptance procedures as well as to whether or not that's really an environment that you should as an auditor be operating in.

And, I guess lastly, a lot of times we have this discussion about large firm/small firm, and there are different ways that small firms and large firms deal with AU 336. However, I don't really think it's a small firm/large firm issue. I think the application of the standard should be consistent and what we're trying to get to should be consistent. How we get there may be slightly different, but I don't think there should be different expectations from a small firm or a large firm. The standard needs to be consistent.

MR. BAUMANN: Thanks, Jean. Jeremy Perler?

MR. PERLER: I had more of a question which is probably better after lunch, so I'll yield my time to lunch.

MR. BAUMANN: Good, you yield to Bill Platt for the final word. And by the way, I didn't mean to infer that others should take their cards down, that after we have discussion of the auditor specialists later if you have your cards still up, you'll be the first ones to be called on.

MR. PLATT: Okay, knowing that I'm the impediment to all of us heading to lunch, I guess I'll try to be quick. I wanted to just reinforce several things that were said here, particularly David Kane's comments.

But, you know, I find the conversation very interesting and informative that we've had this morning.

I do think though it's hard when one thinks about the diversity in the types of estimates that specialists are involved in or fair value measurements. It's hard to put them all into thinking of them all as the same. And I think that would be a mistake to think that the same approach should apply to every measurement or to every type of specialty.

I think also as Sri pointed out before is that, you know, what we're dealing with are areas where it's beyond what I would say the core expected expertise of your typical accountant or auditor are. You know, the reason why Loretta is going outside to employ specialists is because it's beyond the core expertise of her team from an accounting standpoint. And from an auditor's standpoint, I think we'd be in the same position. So therefore, they are unique and different than, Jay, you asked about the accounts receivable before. So, I think there is a difference there.

And I do think that that then means that eliminating 336, to my own personal view, would not be a desirable outcome. I think enhancing it and looking to the ISA standards I think is a good starting place to look to as to what might be done. But I think what we have to avoid is ending up with sort of this one-size-fits-all solution that all of a sudden we need to either get into every model or recalculate in every situation. And we've talked a lot about different situations where at times we do and at times we don't. But I just don't want it taken away that the audit profession has moved to a place where we're always recalculating when we're involved specialists.

And a good area that David mentioned before is in employee benefit obligations and actuaries. You know, it's common for us to test assumptions. It's common for us to engage in dialogue between our actuaries and the company's actuary. And it's common for us to look at the end result and say does it make sense given the change in actuarial assumptions during that period but not going in and actually trying to recalculate how their model works or re-performing a valuation also. So I just I would say that if we did move in that direction, I think we need to evaluate the cost-benefit of it as we sort of look moving in a direction like that.

But I think it's been a great dialogue, and I appreciate the opportunity to make a few comments.

MR. BAUMANN: Thanks, Bill. I think it's been a great dialogue also. I thank the SAG members for incredible input and advice on this. The wide range of views were very, very valuable. And really appreciate the panelists in helping kick-off the dialogue. And so, thank you very much, all of you, for your willingness to be here with us today and lead this conversation.

Lunch: Jessica will tell us details where to go for lunch in a second, but let's try to be back here at about 1:15, if possible.

(Whereupon, the above-entitled matter went off the record at 12:27 p.m. and resumed at 1:24 p.m.)

MR. BAUMANN: Thanks everybody for getting back so promptly. We set 1:15 as a target. And we came pretty close to the target. So, thank you very much.

So, this morning we talked about management using a specialist. Whether that specialist is employed by the company or management engages that specialist.

And how the auditor uses management specialists' work as audit evidence. And we explored the extent to which the auditor should perform procedures around the work of management specialists.

So, that's the subject we explored this morning. And we had a very good discussion and a wide range of views.

A lot of people saying Amend 336. But, -- and in many cases, people saying that went beyond the procedures that are in 336 already.

This afternoon we're exploring when the auditor uses his or her own specialist to audit an area where the auditor may not have expertise.

So, the auditing standards also address the fact that the auditor can employ a specialist or engage his or her own specialist to assist the auditor in auditing insurance company actuarial reserves. Or oil or gas reserves or environmental liabilities. Or places where auditors may not have particular expertise.

There are two standards as we laid out in the consultation paper. If a specialist is employed by the auditor, the auditor supervises that employed specialist in accordance with AS 10.

But those requirements are really the same supervisory requirements for somebody that the auditor has a skill to supervise, such as another accountant. As it would be for an employed specialist, who may have different skills.

So one of the questions is, should there be different requirements for supervision under AS 10 when you're supervising a specialist? And then if the auditor engages a specialist, a third party, to assist him or her as part of the audit, then the auditor is in AU 336 and doesn't really supervise that specialist but follows the procedures that we discussed this morning in AU 336.

Questions also arise that of course an auditor's specialist who is employed, has to be independent pursuant to PCAOB and AICPA rules. They're performing procedures on the audit.

An auditor's engaged specialist is really doing the same thing that an auditor's employee specialist is doing, but pursuant to different standards, 336 versus AS 10. And does not have to be independent, has to meet an objectivity test.

So, these are all the questions we want to tee up this afternoon about the use of an auditor's specialist. Compared to this morning's management specialist.

We're going to have panelists which Greg Scates will introduce in a moment. And then we'll take questions.

And again, as I mentioned before, those with cards up will have the first rights for speaking rights for questions. And your question can go either towards the subject of auditor specialists or, if you wanted to follow up on what you heard this morning about management specialists.

So, I laid out a little bit of the ground rules for the next couple of hours. And with that, Greg Scates.

MR. SCATES: Thank you, Marty. First I'll give the disclaimer. The views expressed by the presenters are their own personal views and not necessarily those of the PCAOB, the members of the Board, or the PCAOB staff.

In this panel -- group of panelists, we have five panelists for this discussion on the auditor's specialist.

This is focused on how an auditor's specialist performs the work for the auditor. And how the auditor then evaluates the specialist's knowledge, skill and objectivity with respect to the engaged specialist.

And also how, the auditor then oversees or supervises the work of the specialist. Including reviewing the specialist's work and the conclusions.

And now let me introduce our panelists today. First we have Andreas Ohl from PricewaterhouseCoopers. He's a Partner in the firm and leads the PricewaterhouseCoopers Transaction Services Evaluation practice in the United States.

Next to Andreas is Susie DuRoss. Susie is a Chief Markets Officer and Partner at Harvest Investments. And she oversees the securities evaluation process at Harvest.

Next is Dan Olds. Dan is a Managing Senior Vice President and Petroleum Engineer at Ryder Scott in Houston, Texas. A firm specializing in the evaluation of oil and gas reserves.

And next to Dan is Efrim Boritz. He's a Professor and Director of the Center for Information Integrity and Information Systems Assurance at the University of Waterloo in Waterloo, Ontario.

And next is David Kane, a member of our Standing Advisory Group. Is a Partner at Ernst & Young. And is The Americas Vice Chair of Assurance Professional Practice at Ernst & Young.

And so I'd like for Andreas to get us started.

MR. OHL: Sure. Thanks Greg. Good afternoon everyone.

As Greg mentioned, I have responsibility at PwC for what we call value measurements. So that's both preparing for non-audit clients and reviewing for audit clients, evaluations performed for financial reporting purposes.

We also do some evaluations for tax purposes. Again, that would be both for audit and non-audit clients.

The other thing I do is, I serve on the Standards Setting Board at the IVSC. The Evaluation Standard Setting body in London that was mentioned this morning where David Tweedie is also engaged there.

So, maybe just a little bit about our practice. And then I'll get a little help, maybe our -- get people to understand the role we play in the firm.

So, we sit in the assurance practice, which is also where the audit practice sits. We're in a separate group. We're not in with the auditors, but we are under the assurance umbrella.

And that's important because that means that many of the policies and procedures that apply to the assurance prac -- or the audit practice applies to us as well.

So, we take a lot of the same training. We're subject to the CPE requirements. Obviously as a part of the firm, we adhere to the independence requirements that the firm adheres to.

And we're just on a lot of the same email distributions and the like that the audit practice would be. And I think what that does, it builds an awareness amongst all of our staff as to what's going on in the accounting and auditing community.

Obviously, most of the folks on our staff have a finance background. Many of them do have some accounting background. We have some dual majors.

In fact, that's something we try to target. Just because, you know, I think it was referenced this morning, having finance folks who have some appreciation for the accounting world is helpful when you play in the space of preparing evaluations and reviewing evaluations in the financial reporting context.

So we have about 250 people. We do approximately 2,000 audit reviews per year. Those vary dramatically in size.

They can be a couple of hours if it's a small company and it's a plain vanilla stock option valuation. Too, it can be hundreds and hundreds of hours if it's a large complex, cross-border transaction that has a lot of moving pieces.

We have a number of standardized templates and tools that we use for our audit reviews. Those get used by everyone across our practice.

They depend on the nature of what we're looking at. So we have separate tools for business combinations versus impairments and things of that nature.

We've had those in place for a number of years. And we update them all the time to reflect whatever the latest developments are.

Maybe just to -- I'll preempt one of the questions that I always get. So, I mentioned early on that we do both prepare, and we review.

And one might ask well, why do we do that? Why don't we just have people focus on reviews?

And the very simple answer to that is, our experience has been that if you have people who actually prepare the valuation and therefore have to start with a clean sheet of paper and say, what are the assets? What information do I need to figure out the values?

That that kind of a thought process is exactly what you want when somebody reviews. Because if you don't have that, let me take a very broad perspective, your focus is very much, what is on the piece of paper that someone has already given me.

You know, they identified five assets. Well, I want to always step back first and say, can I think of something based on what I know about this industry, this company, that isn't on this piece of paper that maybe should be?

And that may be where my line of questioning starts. So, we find that that perspective is very valuable. And frankly, it's something we use when we recruit staff.

And it's very much embedded in the way we do our training as well. All of our training courses have a mix of preparing and reviewing concepts built into them.

I think maybe another thing that's important is, obviously because we prepare evaluations, we have a number of models that we've developed in-house for purposes of valuing business and tangibles and other types of interests, debt instruments, whatever it might be.

Those are the same tools and the data sources that we subscribe to that we use to prepare valuations, are the same ones that we use in the audit process.

So, if we're running some sort of a sensitivity or shadow calculation to get comfortable with something the appraiser has done, when we're in a review capacity, we're using our models that we would use in a non-audit capacity to run those sensitivities.

So they're models that we've checked. All of our staff are very familiar with. And we're following the same process that we would when we're reviewing that we would if we were preparing.

And I think that's important because I think a few people have mentioned this already. The market is a bit of a check on the non-audit work you do.

And so you get a high degree of comfort with your models because of how they survive when they're challenged by others when you're in the preparer capacity.

In terms of how the audit pro -- or the review process works, you know, we work jointly with the audit teams. We're often on calls together with them, with the appraiser, with the client.

Understanding the models, the assumptions, the inputs. You know, I will say, there's a lot of discussion around models. And, at least as it relates to business valuation and tangibles, things like that.

While every firm has their proprietary models, at the end of the day, they're not really that different. So, the area of focus really is not so much, do I like their model? Did they use the right model?

It's more on, where did the inputs come from? And what level of diligence was done around those inputs?

So, there was a bunch of discussion this morning on credentialing, so I get to take half of my notes away, because I was going to talk about that at length. And it sounds like there might be some more questions on that.

So, I'll talk about the other piece. Which is, one of the crucial differences between the accounting / auditing profession and the valuation profession, is that while there are bits and pieces of standards around how to perform a valuation, it's not nearly as comprehensive or robust as what exists in the accounting and auditing profession.

And so, that same process that has been started, that has a lot of momentum behind it around credentialing, is also happening around what we would call performance standards.

And to me the key piece of that is, if you're going to sign something and say it's a valuation opinion, you need to say it's in accordance with some set of standards. Because right now, a lot of valuation opinions aren't prepared in accordance with a specific set of standards.

They're basically prepared in accordance with firm policies. Which obviously vary. And those performance standards will have some real robustness around what does one need to do with around diligencing inputs?

Do you need to come with alternative sources of data beyond just taking inputs from whoever has engaged you? And to me, whatever comes out of this process, I think needs to encourage the profession to head down that path.

Because, where I'd really like to get to is a place where the quality is built into the appraisal process. And not that most of the quality is built into the review process.

And I think right now, that balance may be a little bit off. And I think it's driven largely because that professional infrastructure and the valuation community isn't quite where it needs to be.

I think the valuation profession has gotten that message. And it is moving rapidly in that -- moving rapidly in that direction.

I think maybe a little bit more just on the process. And then I'll pass it onto the next speaker.

So, we will do diligence around the inputs. We will run math checks to make sure the model is, you know, mathematically correct.

We will look at certain logic concepts in a cash flow model. For example, there's just certain pitfalls that you've seen 100 times before. Those are the kinds of things that are on our check lists.

We'll also work very closely with the audit team on the inputs. And that's where -- that is often a joint exercise. There's certain inputs where we're better equipped to question and challenge the appraiser or the company on them.

There's others where the audit team is better equipped. And in our documentation, we make very clear which pieces we've got covered. Which pieces the audit team needs to cover.

That collaborative process, which I guess I would describe as you want people to focus on the things that they're best at. It's very hard to find somebody that's good across that entire spectrum.

And so, that's the way we've sort of built up our model.

MR. SCATES: All right. Susie?

MS. DuROSS: Susie DuRoss. I'm here on behalf of Harvest Investments. I am -- again, the opinions and comments that I have are my own. They're not firm comments.

I'd like to start to say that Harvest as a firm does agree with what the PCAOB has done with regard to improving fair value. At Harvest we really aim to make the rules understandable, easier to implement, and cost effective for firms of all sizes.

Harvest is, to use the terms from the paper, an engaged specialist that is engaged by the audit firms. Most of our client base is the second tier and smaller audit firms that struggle because they don't have a full internal department to handle all of their valuation needs.

We have been in the business of fair value for audit clients and the reporting industry for more than 20 years. We conduct all of our processes with regard to ASC 820 fair value techniques.

All of our processes are manufactured internally at Harvest. We do not resell any prices. So any Harvest price that you get, you know it's independent. We've created it and we've manufactured that price.

Our management team has vast financial experience. We have ex-traders, portfolio managers, investment systems development. So, we have kind of a broad array of financial backgrounds.

We do present at a lot of the industry conferences. Primarily the AICPA. But we attend and present at a lot of the State conferences.

We do a lot of work with employee benefit plans. A lot of speaking at some of those engagements. And I really think in terms of an independent source, we're probably one of the only that exists for reviewing products such as alternative investments, insurance contracts, synthetic GICs and the like.

Two of the management team did serve on the Pricing Sources Task Force. And truly we do aim to bring clarity both to the complexities of the market and the complexities of complying to the regulation.

I was asked to do a little bit about our process, how we go about valuing our securities. Basically, our process is intended to provide transparent, cost effective, prices and fair values for our audit clients.

We basically look a little different than some of the pricing sources that are out there. Because rather than trying to price every security that exists in the universe on a given day, we work on focusing our efforts to our client's portfolios.

So, we'll get an audit client that sends their client's portfolio to us. And then we work on those securities and the values of those securities on the valuation date.

In order to do that, we take the full portfolio and we classify each individual security into a very, very discrete market sector. Now, this doesn't just mean the issuer sector.

I think there's a lot of misconceptions that, you know, all agencies trade the same. All municipals trade the same. All corporates.

We really dig in and for valuation purposes, it's very, very important to address the structural nuances of each of the security types. That's what helps us determine how to go about valuing each of the securities.

I would also like to point out that the market has become more robust in the structures that are being used. Prior to the financial crisis, we saw a lot of structuring in the assets.

And then, we kind of saw it go away. And now, as of the 2014 audit season, most of the CDs we saw were structured items that had coupons linked to all sorts of external indices.

And it would be very, very, very easy for a field auditor to pass over those items. Similarly to how it's very easy to pass over an alternative investment because a lot of the names look just like a mutual fund.

So, we basically go about sectoring all these items by subscribing to multiple sources. All of the basic standard financial information. We subscribe to all of that.

We use 200 data points on every single item in order to appropriately define it into a sector. We also store all of the trading that occurs in the marketplace on a daily basis.

We take all of the trades from the exchanges and reporting systems and we store those in our internal processes. And we use those as the basis for a lot of the documentation for our prices.

The first thing that we do once we've sectored the securities, is we do check every single security against our vast database of traded securities to make sure if something is traded.

We have very strict, consistent policies in terms of what will pass our QA in order to use a trade or a roll of a trade that occurred, that address value and proximity, outlier trades, that sort of thing.

If we have the trades and the QAs, we go ahead and we use that price. If we can't -- if we have an item that doesn't have any trading, or if we have an item that doesn't pass our QA, it does fall to kind of a modeled approach.

We go about pricing and determining the models based on the structural features. So, if we have an item that has a lot of options, we would use an option adjusted, discounted cash flow model.

I'd like to kind of reiterate what Andreas said, every time I come to D.C., I hear a lot of talk about the model and the model and the model. And I would say -- actually, I'm going to come out, I've been at Harvest for 12 years, I've never had a valuation variance that was the result of a model.

It's always the input. And the key is really how well you can document the input that you're using.

So once we get through, we basically pull of our documentation from our inputs using the highest level inputs that we can and that can be observed in the marketplace. We use our database of comparable trades that are sectored. And we can identify many and put them together.

We look at specific deal performance. We look at the credit features and structural nuances. There are many checks along each of these different pieces. And each is documented for our valuation system.

So, basically, we follow a very consistent process that we're using the highest level inputs that are available in the marketplace in order to come up with the values for our securities.

We do also help with -- oh, one important thing, we level according to how the security is valued. So according to the guidance, the level should be based on the lowest level input used in a valuation.

At Harvest, we do do that. So, we know, because we've documented each of the inputs. If there's one that we can't document as strongly as we'd like, that security will drop to a level three.

We do help our clients with follow up and documentation. Right up front we give -- every price comes with the model that we used, the level that we used, a link to the general methodology for that sector.

So we have a kind of a lot of information in our very basic report as to where the prices some from. So you would know right up front if it's based on documented trading in the exact security.

Or if it's based on trading in a like security. If it's based on some sort of other model that would be listed.

We do make all of our pricing inputs available to our clients. In addition, and probably more importantly, we give the reason and the documentation and what you can observe to support each of the inputs that we use.

With regard to quality control, you know, we have a lot of things in place. I would say the first thing is that we have a preapproval process.

We're primarily engaged by the auditors. But we do have quite a few direct clients that come to us in search of some of our expertise.

We never take a direct client unless we confirm with the audit client that it's okay. Most of that generally comes from referrals from our audit clients. And we always get preapproval before we move forward in that vein.

We work very carefully with each of our audit clients. We do conduct preplanning. I wouldn't say every single, but the majority of the firms we work with, come onsite.

They talk with us. We review how the process is going to go on an annual basis. We have preplanning meetings. And we discuss their objectives. The scope and expected volume of the work. The deliverables.

We review the Harvest reports and the samples that we have, to show them exactly what they'll get. We discuss issues that might affect timing and return of the prices.

We discuss our qualifications and our processes.

We do do a sample review of several different security types and the process that we go through to value those.

We also assist the audit firms with enforcing national rules from the standards groups at the central offices. We can assist when field auditors come to us, in helping pick appropriate samples that address risk and other features.

We do help with follow up work with regard to variances. Again, most of the time, those variances result from the actual input.

And you know, I think there's been several comments about how widespread when you look at some of these level two and level three type instruments, that the two different prices are. I do think that's a little bit of a challenge.

Because sometimes when we get to the bottom line and we're looking at a level three, we're following the guidance in terms of saying, when the level three guidance came out, it specifically states that you are to use the inputs that would compensate both the buyer and the seller for the inherent risks in the deal. We adhere to that.

So basically what we're trying to get to is kind of a middle market price where a buyer and a seller would execute a trade. Not the price where the client necessarily wishes it was, or the price where someone could for sure sell it to any number of people in ten minutes.

We're looking kind of for that cross level where two people would be comfortable transacting.

With regard to independence, again, we do manufacture all of our own prices. We document everything. We're not a reseller.

We've given some thought to the staff consultation paper with regard to conflicts of interest and investor tests. We would be prepared to put in place some sort of employee background investigation policy that could potentially address material conflicts.

And we could potentially sort through that as the reports came in the door to ensure that we wouldn't have conflicts in that area.

We do have quality assurance steps at every single stage of the process, data management and valuation. Some of the checks are automated and some are human.

We never have an analyst only do a valuation. Everything's always checked by two people.

And lastly, with regard to skepticism, our analysts are trained to apply skepticism. You know, I think that what the engaged specialist might lack in terms of adhering to 10 and following the firm independence rules, we do not have any stake whatsoever in the results of the audit.

So, I think that there is a true independence that comes from an engaged specialist that doesn't necessarily exist with a lot of the other methodologies.

So, at that, I'm happy to answer any questions that you have regarding our current practices and the feasibility of some of the new practices that are suggested. Thank you.

MR. SCATES: Okay. Thanks, Susie. Let's turn to Dan Olds.

MR. OLDS: Okay. Well, good afternoon, everyone. I'm Dan Olds. And I'm a Petroleum Engineer. I've been doing valuation work for over 30 years.

Ryder Scott is one of the largest valuation firms of its kind in the world. We've been around since 1937. We've got about 130, 140 people in three offices. And we work pretty much worldwide.

We worked for public companies. We worked for private companies. We worked for national oil companies. We worked for governments. Chances are, if it's an oil and gas project any place in the world, we've probably taken a look at it.

So, with that, with the seven minutes I'm allotted, I can't explain to you how we valuate oil and gas reserves. So I'm not even going to try.

But I am going to try to focus on the things that the PCAOB asked me to focus on. And the first thing here is, how does the industry work?

Well, there's no SEC requirement to use a third party firm like ourselves for reserves. Many companies calculate their own reserves with their own internal staff.

They all have their own engineers and geologists to do the work. But, third party firms like Ryder Scott may be engaged by companies to either calculate or part of the reserves or audit their reserve calculations.

And let me add that some companies use multiple consultants like us depending on the project and the expertise that they're looking for. So we may be one of many consultants that a large company might use.

And why would a company want to use a third party like us if the SEC says they don't have to? Well, an independent objective view may be required by the Board of Directors, the audit committee, or the financial backers, the bankers, the investors may demand that the company use an independent firm like ourselves.

We have specialized technical expertise or specific experience in a particular area. Especially since typical third party firms like ourselves get to see many different projects around the world.

Familiarity with SEC requirements and latest industry issues is also something that, you know, we do this every day. Whereas companies' reserve engineers are not necessarily doing SEC reserve work.

They're doing the internal kind of work necessary for business planning, budgeting, and project development, which SEC would be a subset of that. That's a very specialized subset.

And of course outsourcing. You know, some companies prefer to have us do all the work rather than have the staff themselves.

Quality control, how do we do it at Ryder Scott?

Well, I mean first of all, our staff is required to avoid any investments in client companies or oil and gas properties that would create or give the appearance of a conflict of interest.

We have significant continuing education both in-house and outside. You have to be a State licensed engineer to be an officer of the company and to be able to sign reports that go out the door.

The younger staff works under the direction of more experienced staff. Company officers review final reports before signing off.

And of course, it kind of goes without saying, is when a project comes in, we look for expertise in the company and assign that project to whoever we feel has the best expertise in that area.

We have various error checking procedures used throughout the process to ensure the integrity of reports. Including frequent communication with the client.

And what I mean by that is that in many situations, our clients are the real experts. They have, you know, for a large oil company, they may have a staff of people as large as what's in the room working on a large project year around.

So, they're the experts. They really know these properties. When we come in, we may do the year end reserve calculations, but it's somewhat of an integrated process that we come up with a number and we show them what our number is.

And they can say well, yes, we agree with that. Or no, you've missed something. You know, because there's so much data. We can't look at everything.

But, they can help us focus on the key points. And help us to show us where we might have missed something.

And sometimes, we acknowledge that. And we say yes, we see your point and we can adjust our numbers. And then other times, we say well, we just have a fundamental disagreement and we're just going to have to agree to disagree on this.

Neither our employment to do the work nor the compensation is contingent on our estimates or reserves for the properties in our reports. You know, our pay is not contingent on the answer that we come up with.

Certification was mentioned earlier today. There is no industry certification for what we do that's mandatory.

I'm a State licensed engineer. I'm a petroleum engineer. But, that doesn't really have specific evaluation experience, it's more general. All petroleum engineering aspects.

But, having said that, we do pursue some certification in the form of I'm a member of an organization that requires ten years of specific evaluation experience and references. We encourage that. We have addressed some of the certification issues that were mentioned here earlier today.

Working for an audit firm. Well, I have a background for nine years I worked for an audit firm as a part of their energy consulting group.

And I can say with confidence that audit firms have oil and gas staff well qualified to opine on accounting issues and general SEC compliance. But, I would have to say that, you know, in my experience, that the audit firms may have limited or no staff with significant experience to opine on detailed engineering issues.

For example, you know, even if you're not really up on oil and gas, you're probably aware of the big shale projects that's going on worldwide. And specifically in the United States.

And you know, that's one of the areas where we don't have a lot of history. The oldest shale project in the United States only started producing in the late '90s really.

And we don't know how it's going to have a 50-year life. Because we've not seen it yet. So, you know, questions about the future performance on these kinds of projects is something that I would not expect an accounting firm to be able to look at with any level of expertise.

Situations that we encounter every day like the appropriate determination of reserves, classifications for undeveloped locations, that's always a big issue in our industry. That's again, that's something that I would expect accounting firms to have a general idea.

But to be able to argue the nuances of something like that, would not be something that I would expect.

So, one of the questions that was put to me is, how would working for an audit firm differ from working for the company? And from my perspective, it wouldn't make any difference.

We don't couch our answer on who our employer is. We want the right answer. So we would not differentiate. We would expect to follow the same workflow and to arrive at the same conclusions regardless of the client.

I would point out that we often work for multiple companies who have interest in the same property. You may not be aware that most oil companies manage their risks. They manage their portfolio by not owning 100 percent of these large projects.

There may be multiple owners. Many large oil companies, maybe some national oil companies. Every deal is different.

And it's not uncommon for us to be working for two clients who have ownership in the same property. And in that case, we have the same answer for both clients.

Working directly with the company generally ensures better access to data and the company staff. As I mentioned earlier, it's somewhat of an integrated process.

The company's staff is really the number one expert. And to think that we could come up with a good answer without consulting with them, and again, I want to point out, not accepting their views in all cases.

But getting the benefit of their knowledge is an important part of the process. And the other thing is that, you know, reserve work goes on year round.

In talking about some of the issues here of, you know, how would it differ if we were engaged by an audit firm? Well, you know, there's not enough time at year end to start the reserve work and get an answer.

You know, if we start on December 31, you know, it's not going to work. We do a lot of projects in the summer which is our -- we used to say that summer was the slow season. But now it's just our less busy season.

But many large clients will have us work on special projects, general engineering issues that will have some applicability to year end reserve work. And so, you know, we manage our work load by working on those kinds of projects.

The reserve work goes on almost year round. And so that would be an important thing to consider here.

And that's probably about all I can fit in my seven minutes. But I look forward to any questions that you may have later on. Thank you.

MR. SCATES: Okay. Thanks Dan. And now we'll turn over to David Kane.

MR. KANE: Thank you. I'm going to spend a couple of minutes talking about how auditors use employed specialists.

And just by necessity, I'm going to talk about it more from one firm's perspective. But there will be some similarities and differences I expect between firms, whether large orient or smaller.

So, the first question here on the slide is, when to involve a specialist? So, the audit team considers several factors when deciding whether to involve an employed specialist or internal specialist.

Complexity of and the judgement associated with the estimate. The significance of the financial statement assertion. Thinking about the risk of a material misstatement, whether it's due to error or by fraud.

Effectiveness of the company's internal controls. Whether the client in turn, has used a specialist. And also, what's the team knowledge, past history, experience with the estimate and experience with the client.

Importantly, once a decision is made to include a specialist, that specialist is viewed as part of the engagement team and is subject to additional quality control, review and procedures, just like everybody else on the team, which I'll touch on in a moment.

So, when evaluating the specialist's qualifications, teams are supposed to consider the competence, the capability and the objectivity of the specialist. But typically, teams will rely on the firm's system of quality control in order to make those determinations.

So here what are we thinking about? The independence, monitoring and reporting. The firm's internal recruitment and training programs. And the training is particularly important.

So, specialists will go through foundation courses on auditing that includes whatever the financial reporting framework is. It might be U.S. GAAP. It might be IFRS. Go through PCAOB standards in the firm's audit methodology.

In addition, each year they are required to go through a continuing professional education course similar to what the auditors would go through.

And here it gives us a chance to talk about hot button issues, emerging trends, inspection issues, whether it be internal or external and gives us a great platform to reemphasize the need for audit quality and for professional skepticism.

There's also a quality review program similar to what we have on the audit side, where specialist work will be selected and reviewed periodically.

Another key step here is thinking about the agreement of the work to be performed. So I would say there is probably three key aspects of that.

Early planning, the coordination and the communication. And probably the last piece, which is the most important, is the collaboration.

So, the planning begins up front. So typically, there will be an estimates event, where the team will come together with the specialist as part of making the risk assessment and that determination.

And as part of that, they'll walk through, what's the nature of the inputs, the processes, the assumptions, the methods. As well as discuss what the client's internal control looks like, both in terms of the development of the estimate as well as the ultimate review of that.

And coming out of that will be an agreement about the nature, timing and extent of the procedures that are going to be performed in that area. There will also be roles and responsibilities.

Communication protocols will be set up between the audit team and the specialist. And also what the documentation is going to look like.

So, typically the specialists have some standard documentation that will be provided to the team, both up front in terms of planning, as well as the end in terms of conclusions, that typically describe the procedures performed, results obtained, the scope and things similar to that.

Once agreed, the other key part is collaboration. So, what we've seen on positive quality events is when the team works collectively and collaboratively to look at methods and assumptions.

So Andreas mentioned earlier, discussions with the client for example. Attending client meetings together. And really, it's when the team truly understands the model, understands sensitivity of the inputs, and understands most of the underlying economics of how the instrument is priced in terms of the market.

So, several considerations here when evaluating the specialist's work. First thing is, the specialist's work is subject to a detail review by a more senior specialist.

And will also be subject to a partner, principal or executive director review by the specialist. It's also subject to a general review by the audit team as well.

Key here, is that when we're talking to teams about using the work of a specialist and evaluating it, you want to be thinking about it the same way with professional skepticism that you do as if the client handed it to you.

So we've been working with the specialist all along the way in terms of the nature, timing and extent of the procedures, and partnering with them all during the audit, minimizes the chance for surprises at the end. Which I think is very important in these circumstances.

So, what's the audit team looking at when they get this? They're going to be looking at some of the things that we talked about this morning.

What's the relevance and the reasonableness of the assumptions, of the inputs, of the methods? Making sure that the conclusions ultimately support what the objectives were and what the financial reporting or financial statement assertion was.

They're also looking at the source data and making sure that that was all appropriately covered as well. Ultimately though, it's the audit team that's responsible for determining what constitutes sufficient, appropriate audit evidence.

If the team is satisfied that the results support their conclusions, they could reasonably conclude that the specialist work is adequate. So that concept comes out of AU 336.

With respect to documentation, so when using an internal specialist, we view that documentation no different than if it was prepared by any other staff member.

So, the documentation for the team as part of the archive has to stand the evaluation of that an experienced auditor with no, you know, history with a client, or with the team, has to be able to come in and make a determination about whether the papers are clear about the nature, timing and extent of the procedures, the results obtained and the conclusions reached.

So again, no different than any other member of the team. In terms of the auditor engaged specialist, less common I suspect at the larger firms, key differences are, that you can't rely on the system of quality control, so you have to be here thinking about independence, objectivity, competency and capabilities.

You also have to think about confidentiality to make sure that the specialist is going to respect that. And then there's a free exchange of information between the auditor and the specialist.

A couple of observations here similar to what I made this morning. I think there are some opportunities to enhance AU 336 here and probably pick up some of the language that's in ISA 620 and AU 620.

I think the other point here too, is the rescission of AU 336 would probably have more significant consequences for auditors and for companies. When I think about ASC 820, and when that was issued, there was a lot of discussion about fair value measurements.

What's the framework? Thinking about market participant assumptions. And specialists and auditors really used that opportunity, I think, to up the game.

Where auditors understood much more in terms of the framework and actually how these instruments are priced. And I think coming out of that became better auditors.

No matter how much time you spend with an auditor, you're not going to be able to convert them to a reserve engineer with this. So, I think there has to be some recognition and reliance on the fact that someone is a specialist and outside of the auditor's expertise.

That's what I have. The big picture.

MR. SCATES: All right. Thank you, David. Now, we'll turn to our last panelist, Efrim Boritz. Efrim?

MR. BORITZ: Thank you very much. And thanks for inviting me to share some of my research with you.

The material that I'll be covering with you is the result of the last two years of work by a team of four people. It's based on 40 interviews of all Big Six firms, including half auditors at the various levels, various ranks, and specialists in various specialty areas.

So, I only have four main headings that I'm going to be covering with you. Planning, supervision, coordination, review. Then some issues about the definition of specialists and engagement teams. And then some other observations.

One of the things that I observed in conducting these interviews is that the audit teams have accepted the notion that the audits are modules. They're modularized like Lego pieces. Or someone used the example of IKEA furniture.

So, the different parts of the engagement are carved out and passed over to specialty groups in certain areas. And this is not a criticism, but it's a certain way of thinking.

Because with that modularization comes a handing over of certain responsibilities. And that can raise some issues that I'll get too later.

The modularization is not just modularization sections of the audit, but you can think of it as a certain slicing of layers. There are specialists who have expertise and knowledge that other members of the audit team do not.

So, there's -- they're just carved apart by virtue of the fact that they have different competencies. And they have different languages and different ways of talking. So, any standards have to take into account the fact that there is this layering.

In many of the firms, the specialists are in different business units or different divisions. Although, when they're working on the audits, they interact with the other members of the audit team.

They really have a different reporting chain, a different way of being employed, quality controlled, and they have their own review process as David has just mentioned, that may not be transparent to the audit team. There's a requirement for a lot of trust in the firm's way of organizing itself and the quality control process.

And the modularization also exists in the archives and databases that the firms use to manage their audits. It's quite common for the specialists to write memos to file summarizing the work they've done on their module and deposit it in the archive.

And then it depends very much on the proactiveness of the management team, the management of the audit, to make sure that those things -- those modules click together properly. Because it's very common in the way today's audits are managed for those to be really individually manageable and individually completeable sections.

The participation in the engagement is very much at the discretion of the partner in charge or the manager in charge of the audit. The specialist's role is passive. And they -- even when they have knowledge about the industry, they may not be able to apply it.

They're often not in the position to question whether their involvement -- their lack of involvement is properly determined or not.

So, this is unsatisfying to many specialists. And it does not necessarily lead to the team spirit or the cohesive engagement team that we would want to imagine.

The integration of specialists into planning is not always carried out consistently. Some specialists are routinely brought into the planning meetings. And others have their own separate meetings.

So for example, tax specialists and IT specialists are routinely involved in up front planning. Valuation specialists and forensics and others that are brought in as plug-ins, may not.

And so the integration that is necessary for a team to be a team, is often not there. And should be addressed in any kind of standard revision.

I'd also want to mention the distinction between the involvement and scope. Many of the firms have policies that specialists need to be involved in some aspect of planning and so forth, and they are.

But, the distinction when you dig deeper into discussions with the various participants, you find that the difference between involvement and scope can be very dramatic.

So, the -- so you need to know the language of the auditors. And the specialists' involvement may be insignificant. But it's checked off as involvement and complies with firm policy.

The scope may be insignificant, but the involvement is binary. So, it's something to be aware of.

My next set of points deal with supervision, coordination and review. In our interviews, we became aware of both auditors and specialists being concerned about the coordination and communication.

Especially because of this modularization that I referred to, often specialists are given their assignment, they're given a time line, maybe a budget. And they're really then performed.

There is often not as much communication in that process as both parties would like. That's obviously to do with management and firm dynamics and busyness.

Again, this is not finding fault, but both specialists and auditors complain about gaps in communication. And of course, that means that there's not the benefit of transferring information and knowledge about issues as they arise in a timely manner and can lead to issues.

The auditors often assume that review is done by specialists. And from what my understanding is, and from what I've heard David say, there is a separate review process that exists within the specialist ranks.

And it might be very effective. But the auditors are not very involved in that process. They have their review process is much higher level. There is a process, but it's much higher level.

And there is not as much transparency in the review process that's carried out by specialists of specialists, in terms of the employed specialist teams as you would want if the engagement team were truly charged with being responsible for this. As being solely responsible as some of the standards essentially assert.

Specialists are at times -- do at times accept the audit work at face value. Some are not able to because they don't have enough accounting or auditing training to challenge the evidential quality of the data that they're given to put into their models.

And for example, one of the examples that was used frequently was that many tax specialists can provide an assessment of the propriety of the provision. But they can't actually evaluate the propriety of the disclosure and the accounting for that provision.

And that's because some of them have a lot of tax expertise, but not a lot of accounting or auditing expertise.

Specialists believe that the auditors that they work with do not have the capacity to thoroughly review their work. This is not to say that they don't think the work is carried out properly or that it's not reviewed, it is reviewed.

But, to the extent that the auditors, the audit team is charged with driver -- of being in the driver's seat and driving this process, they may not have the competency.

And you could imagine that this would have to be the case. The reason they're using specialists in the first place is because the specialists have knowledge, skill and experience that they themselves don't have.

So, it would be asking for too much to demand that they perform a detailed effective review.

My third main set of points deals with definitions. I am not a fan of the definition of specialists in our standards. That for example, use the phrase other than accounting or auditing. But I could live with that.

I am certainly not a fan of the fact that what goes into that other than accounting or auditing. I've already mentioned IT specialists and tax specialists.

They're considered to be within the accounting and auditing realm. And therefore, most of what we're talking about here is not being addressed.

But, within the firms, those people are viewed as specialists. They are in different business units in many cases. They do have different reporting structures.

And in some cases, increasingly I think, but this, it would have to be verified by others who may know more about this then I do, increasingly, the forensic, IT, tax and even valuation specialists, do not have strong accounting or auditing backgrounds.

They have backgrounds, deep backgrounds in their field of specialization, valuation, finance, IT, forensic, tax, but so this illusion that our standards have that tax, IT and forensics for example, are a part of the accounting or auditing background of large audits of sophisticated companies, I think should be challenged.

It's true I think for smaller companies that this is something that you can't often assume. But, for the large type of audits and the people involved in those large audits, both the auditors and the specialists, I simply don't think that that's accurate.

And to the extent that we don't include them, because they're just invisible in the standards right now, because they're just an exclusion, we don't benefit from having the standards provide guidance for people who work in these specialties. And who are very, very important, in some firms they are mandated to be involved on every audit, especially in the large firms.

I also have some issues with the definition of engagement team. And that's because of things that I've already said.

The engagement team I think, is a virtual team. But it's not a team the way we think of as a football team or a baseball team.

They don't work together in many cases. They do sometimes. Sometimes the doorway to the client for a valuation specialist is through the auditing member.

But once the door is opened, the valuation specialist is basically there interacting with the client. The IT specialist is basically there interacting with the client.

So, it's not -- and of course, I'm sure that there are instances where they work hand in hand and collaborate and so forth. But in the large audits that have as the consultation paper refers to, they may have four or five different specialists working on it.

That type of collaboration I think is a luxury. And it's just, from what I understand from the research we did, it doesn't occur that often.

So, there are barriers to team spirit as well because the specialists don't want to be buried in the engagement team. They have, as I say, they're part of different divisions.

They have their own training. Increasingly, that's more in their fields of expertise then accounting or auditing.

And although in our research the auditors would love to have the specialists integrated into their team, the specialists are not keen on being integrated because they have their own identities and view themselves as part of a service.

In other words, they're almost like an engaged specialist except that they're employed within the firm. And of course, they're managed properly in that regard.

MR. SCATES: Efrim, if you could -- I think we'll conclude there.

MR. BORITZ: This is my last slide.

MR. SCATES: If you could wrap it up in a minute that would be very good.

MR. BORITZ: Okay. Thank you, yes.

MR. SCATES: Thanks.

MR. BORITZ: So, one of the observations I made is that with the way of the modularizations taking place, I believe that there is a deskilling of the regular audit staff. And we should be aware of that.

Employed specialists have, as I've said, have limited account knowledge and limited understanding of professional ethics in some respects.

And however, we found a number of instances where employed specialists appeared to be more skeptical then members of the audit team because they did not have as big of an investment in the client as the audit team did.

MR. SCATES: Okay. Well, thank you. Thank you, Efrim. Thank you for all the panelists.

And what we'd like to do now is, I know you're going to have questions of the panelists and an ongoing dialogue. We have two sets of alternatives to consider with respect to using the work of the auditor specialist.

The second set we'll just discuss in a few minutes that has to do with the subject that we alluded to this morning, and the panelists have brought it up, with respect to independence and objectivity for the engaged specialist.

And we'll talk about that in a few minutes. What I'd like to talk about now, is your views on alternatives with respect to oversight or supervision.

The first alternative would be to develop a separate standard that would apply to the work of both employed and engaged specialists. And then the second alternative would be to extend the existing supervision requirements in AS 10 to the work of engaged specialists.

So now, I would like to open -- I think we want to first address the tent cards we have from this morning.

MR. BAUMANN: But even if we were to extend on the last slide, Greg, the AS 10 requirements to engaged specialists, I think we also have teed up a question in this consultation paper that is specialists are different than accountants and auditors.

So should there be different or is it more specific supervisory requirements in overseeing the work of a specialist then in overseeing the work of an accountant or auditor, given the fact that auditors who are doing that supervisory work don't necessarily have the expertise in the field of the specialty?

So with that, please your questions can go to us.

Or comments can go to the management specialists, auditor specialists.

But, Chuck Senatore, you had the first card up.

MR. SENATORE: Thanks Marty. It's a question and a comment, and it was actually inspired by Sir David when he talked a little bit earlier about sort about the conundrum around specialists and estimates.

So, you know, the one thing that struck me from his remarks was, you could have an estimated value that's here, that's reasonable. You can have one that's here that's reasonable.

And the delta could be quite severe. And he mentioned that there's really -- so he felt bad for the auditors in terms of having to face that.

But I guess, what I'm thinking about now, is not only just feeling bad for the auditors, but feeling bad for an investor in terms of having such a swag like that.

So, I guess my question is, is there a gap in the standard? Now, I don't pretend to be a student of this, and I basically just know what I read in the materials.

But when I look at the standards for AU Section 336, so you think about that framework, because there's a three part test. The appropriateness and the reasonableness and the method of the assumptions are the responsibility of the specialist.

And then the auditor should obtain and understanding of those methods and assumptions unless the procedures lead him to believe that the findings are unreasonable. And then once you hit that unreasonable level, then, you know, you might want to take a look at another specialist or other procedure.

So my question is, when you think about the fact that estimates are inherently, you know, they're not precise. You can have a number of different reasonable estimates.

And they actually can vary quite a bit. It would be a horrible outcome if an investor had no idea that there was such a delta between a number of different reasonable estimates.

So my question is, the way I read this is that, there's a danger at least looking at this literally. That once you get -- let's say you got to one of the reasonable outcomes.

And let's assume, let's say -- I don't know whether it was Phil or Doug that mentioned this, but let's assume that, you know, we're talking about a specialist that's really sort of tied to telling management what they want to see or hear.

But once you get to that one really good for, favorable to management, reasonable outcome, is it pencils down under the standard? Because you basically -- it's reasonable, we're done.

It feels like a gap to me. I don't know when you look at Auditing Standard 10 where there's a little bit more of a foundation for digging, at least the way I read it in terms of the second element, where the auditor can direct the specialist to bring issues to the attention of the auditor so that the auditor can evaluate those issues.

I guess my question is, and maybe there are things that happen in practice as we learned earlier that may go beyond the threshold of what the standard requires.

But, it would seem to be a shame to have a circumstance where an investor, when you think about the hypothetical that Sir David talked about, not being aware of a delta simply because applying a standard, with the auditor basically found a reasonable outcome without really investigating whether there was another reasonable outcome, and it was pencils down.

So I guess it's really more of a question in terms of whether that there's a gap in the standard in light of that possibility?

MR. BAUMANN: Well, it's a really good question. And it's really I think at the heart of what we're exploring here.

Not only in this project, but in the estimates in fair value projects. And you'll hear more about this again this afternoon.

AU 336, part of the issue is that it was written some years ago. And written before the risk assessment standards.

So if you just looked at 336 by itself, you might say pencils down if you found that specialist work to be not unreasonable. The engaged specialist's work to be not unreasonable.

However, the risk assessment standards say estimation uncertainty is something the auditor should take into account in assessing the risk of material misstatement.

So if there's a wide degree of estimation uncertainty or a wide range of possible outcomes there, the auditor should take that into account in terms of their nature, extent, and scope of audit procedures.

And therefore, 336 right now is not directly linked to the risk assessment standards. One of the issues in terms of our need to update the standard.

Because to your point, and many commenters on the previous consultation paper on estimates and fair value said they've encountered situations where estimation uncertainty can actually be wider then materiality established by the auditor for the financial statements as a whole.

And what do we do when estimation uncertainty, any of those outcomes in there seem reasonable, but that estimation uncertainty is wider then the materiality we've established? Well one thing hopefully is that the financial statements disclose that estimation uncertainty.

But what else should the auditor be doing? They can't narrow it, the estimation uncertainty.

But what procedures should they be preforming to determine that management has determined most reasonable estimate within there, or how management has rejected other alternative assumptions, you know, within that wide range.

So, your question, I think I don't have an answer to it. It's part of this whole project of improving our standard around specialists. And improving our standards around fair values and estimates to say yes, I have to pursue that further. It's not just pencils down.

MR. SENATORE: I guess this -- my only other point here and it's a follow up, is a wrinkle in terms of the specialist scenario. Because by definition, there's a great deal of reliance.

We just talked about how there's no inherent expertise in some areas. And you are relying on somebody else.

So the question to me is, does the standard need to reflect some degree of accountability, control or ability to kind of see when you are relying so much on another party to even know if you have a window of different estimates that might end up falling into what you talked about.

I just don't know whether that's present.

MR. BAUMANN: That's a really good question as well. Because, does the auditor know that the specialist has a wide range of estimation uncertainty?

The auditor may not know that unless that's properly communicated from the specialist to the auditor. So there are a lot of good questions there that you've teed up for us to consider as part of our standard setting.

Next was John Lukomnik. I probably say that wrong every time John.

MR. LUKOMNIK: John is fine.

(Laughter)

MR. LUKOMNIK: So this also goes back to the discussion before lunch. But it probably has more relevance now, so I'm glad it got held.

The discussion before lunch was sort of incremental modifications to 336. And I'd like to suggest that you consider what I would call a low cost chicken soup approach.

Which is, you know, something that couldn't hurt. I would say probably would help. But at lunch we were having a discussion about the definition of probability.

So I'll say might help.

There is no requirement in 336 for requiring communications from the auditor to the specialist. That's important for a couple of reasons.

Number one, there's all sorts of behavioral studies that's just a, when you remind someone of what they're supposed to do ethically, they actually -- there's an increase statistically in ethical behavior.

But more importantly, and this gets exactly to your point and to one of the things Susie said, for company hired, for company employed or engaged specialists, their estimations are done for a purpose other than for audit usually.

They're done for valuation of a merger or a sale and acquisition as Loretta had mentioned. I've been engaged as a risk manager on financial products, and Susie gave her thing, which was, it's not a clearing price in ten minutes where you can sell everything. Neither is it what management should be.

But if you're a risk manager, you may in fact be saying okay, if there's a liquidity constraint situation, what's the market clearing a price for this strange derivative within five days, which is what you've promised people? Which may be different than fair value.

If in fact there's no required communication from the auditor to the company either engaged or employed specialist, there's no reason to assume that they will understand what the purpose of their estimation is.

And I think it would be very helpful, you can't control what someone not in the employ of the auditor does necessarily. But you can certainly influence behavior by saying, here is how we are planning to use it.

Here is the purpose to which it is to be used. Here are the standards that we think we are applying. Do they match that? Or are you in fact, did you do it, did you value it for a different purpose?

And so, I would like to see whether you -- however you strengthen 336, for there to be a set of required communications from the auditor to the specialist that explain how those estimations are to be used as an audit context.

Because without that there is, I think, a high probability that a large number of the specialists will give -- will have perfectly valid, as you say, reasonable estimates. And they may be for different purposes.

And that's another reason, not just the assumptions, but the constraints around them, and the goals of the purpose that give you a wider variety then would otherwise be necessary.

MR. BAUMANN: Those are good points. Because those are the elements of -- part of the elements of AS 10, supervision, the communication that you would have with employed specialists in directing them and communicating with them as to what they need to do.

So, that's a key improvement to 336. Bob Herz?

MR. HERZ: I guess my comments start with the presumption or more experience that how you write the standards. And then how the auditors will react and how your inspectors will react to those words, have very important behavioral consequences.

So you have to be very -- you're never going to get a complete Goldilocks up front on all that. But, there are some things you can, I think from experience do.

But you're trying to at least get to that, you know, not too much, not too little. Do the right amount to get the comfort.

In that regard, I think as David Kane mentioned, you know, one of the big issues that came up when we were setting what was then 157, was around the level three valuations of how much is enough to get reasonable inputs, particularly to, you know, kind of say take a market participant type view?

And you know, in particular, you know, there were concerns by the preparers at that time that if we left it kind of just without some guidance, that the auditors would engage in a search and destroy exercise to find almost anything that, you know, they could hang their hat on and put in a work paper and the like.

And some of that -- so the words in 157, they're around level three valuations, you know, talk about management using its best estimate, but not ignoring market evidence that's readily available.

And that does not mean that you've got to, I can't remember the exact words, but do a search and destroy exercise. And so, I was thinking of that in this context. And the prior discussion of the two alternatives you were considering. And it might apply to both.

But I was thinking in the first instance, if you removed -- rescinded AU 336, what might that do to that kind of behavior? Particularly since, you know, you're very much emphasizing in some of your standards and inspections that the need for the auditor to consider, you know, contrary information.

And I'm not prejudging one way or the other. It's just the issue of getting to the right -- to the right balance there. I think that goes back to some of these things that some of the valuation folks talked about.

Is that -- like Andreas talked about, that you know, they're -- within even a level three valuation, there are some assumptions that can be triangulated or market corroborated. There are others that cannot.

And it's often very fact specific to the type of, you know, asset and the type of financial instrument or whatever. And there's no way you're even going to be able to prescribe all that stuff. That should be in the valuation standards that develop.

But, I guess my overall encouragement is to just think about that, you know, that behavioral balance.

MR. BAUMANN: That's an important consideration. And I think we've gotten a lot of that advice today I think, and similar advice in different ways that moving maybe towards the IASB in this area, which has, not as far as we've possibly said is some of the options in the consultation paper, but it has potential other improvements that are pretty close to it.

Sort of getting to your Goldilocks. They're trying to get it just right. It's looking at the various -- what they have in the ISA compared to what we're talking about today. Thanks.

MR. SCATES: Bob, are you thinking that maybe we should do more in the review and supervision from the auditor's perspective when they're reviewing the work of the specialist?

MR. HERZ: I'm thinking, well first, I start from the premise that on the one hand, the preparer's got to do the financial statements. And they've got to do whatever they need to do to get comfortable with that.

And that is their responsibility to do that. So they need to do that. But, on the other hand, the auditor's got to come after that and make a judgment.

But you want the level of inherent process and scrutiny over that process to be consistent between what gets done by the preparer and what gets done by the auditor, with the auditor still looking at it. And doing what they think is necessary.

And you know, we found there have been the consequences of the way standards are written, the way inspections are done, the way auditors interpret things that have very big behavioral consequences that probably weren't initially intended by the standards, you know, the way they were written.

So I'm just saying, you know, think about that.

MR. BAUMANN: And finally, just to follow up more time, and that is, I guess we want to certainly avoid having the auditor do more work around the work of the specialist than management has to do around the work of their specialist for preparing the financial statements.

That's certainly part of what you're saying. Right? Thank you.

Maureen McNichols? Oh you? Your card's down, sorry. Liz Mooney?

MS. MOONEY: Thank you. You know, this project just strikes me as really important, you know, for the profession and for the future.

I mean, this is the future with more and more estimates and judgments. And these are numbers that are in the financial statements, unlike the non-GAAP issues we were talking about earlier.

So, I think it would be useful to have the auditors, you know, test the evaluation inputs and review the methodologies by specialists, whether they're employed by management or the auditors. And I would expect investors would be happy to pay for it.

I mean, and I don't think you'd get complaints about a higher audit fee to have better assurance about these numbers. I think they expect these numbers are audited already, so.

MR. BAUMANN: Yes. So if management is using a specialist to prepare a complex oil and gas estimate the auditor can't necessarily review that, the auditor should be using his or her own specialist your saying to work under the auditor to review that.

Is that your point? Right? Okay.

MR. MOONEY: Right.

MR. BAUMANN: Thank you. Jeremy Perler?

MR. PERLER: Thanks. This has been helpful and informative.

I just have a question, last from the prior session, but applicable now too. And I'm distinguishing between, and maybe I shouldn't, but there's been a lot of discussion on -- about these black box and propriety and geologic type specialist work.

Which I understand is highly complicated and you would never expect an accountant to understand that. But then, there's also been discussion on using a specialist, and maybe I have this wrong, but for things that feel to be more in the wheelhouse of an accountant, like purchase price allocations, perhaps PP&E valuation.

And, you know, specifically with the purchase price allocation, restructuring reserves are now liabilities or weird situations where accounts receivable and deferred revenue are revalued to map altered revenue recognition patterns, which I've seen a lot recently.

But I guess my question is, are those accounting style decisions being made at the specialist level? Or at the auditor level? Is a simple purchase price allocation audited or not?

And I'm a bit confused on that now. And yes, I guess that's my question.

MR. BAUMANN: I don't know if any of the auditors want to respond. I assume the purchase price allocation is audited.

But sometimes it's audited by -- with assistance from specialists if that purchase price allocation includes core deposit intangibles or some other type of intangible assets that are hard to value by the auditor.

I don't know, Bill, you want to take a shot?

MR. PLATT: Yes. I think that's a fair summary Marty. It's, you know, obviously with a large acquisition, it has some material impact on the financial statements.

There will be auditing of the allocation of the purchase price to make sure that it was allocated in accordance with the accounting standards that are applicable.

Now some of that allocation will be things that are clearly in, you know, the auditor's wheelhouse. You know, you take something like accounts receivable, there might be some minor adjustments for fair value.

But, you know, auditing, you know, are those valid receivables? And are they stated at the right amount on the day it was acquired? There's probably things done by the core audit engagement team.

Then you've got other things. I mean, Loretta spoke before, if she had IPR&D coming in as a result of, you know, a development stage pharma product or drug, then that would involve valuation people.

And looking at, you know, how you go through that modeling to the fair value that IPR&D. And likely she may be engaging valuation specialists to help her on one hand.

And we would have valuation specialists, I mean Deloitte -- within Deloitte, who would then work with the engagement team in auditing whether what was done by the company was appropriate in the circumstances or not.

And doing the kinds of things that Andreas talked about before in terms of what were the critical inputs into it? Who's auditing which assumptions? And things like that.

And so I think all of that's being done today. But, if -- you know, if you had something that was truly outside of the skill sets, I mean, I guess I don't specialize in oil and gas, but if you had some type of value that required, you know, a specialist, an engineering specialist in that respect, you know, then that would probably be a little bit different exercise in terms of looking at that.

MR. BAUMANN: Can I follow up just a little bit further? And David, maybe you can get engaged as well since you talked about both employed and engaged specialists.

So in the situation that Bill just described, and Bill you can talk to it or David, how would -- would the supervision differ? And how would the supervision differ between when the engagement partner or whoever you delegated this work to, supervise that accounts receivable staff reviewing that work?

And whether or not the accounts receivable were collectible? Or do they need an allowance? Or the valuation of the intellectual property, which is done by some specialist, how would you supervise that person who's valuing the intellectual property on your engagement team?

How different is that supervision? Maybe you could help us with that?

MR. KANE: I'll take a crack at that to begin with.

So, let's take an example where they have to work together on prospective financial information.

So, that's going to be a key part of a purchase price allocation. Both parties, both the audit team and the specialists who have to come together, the audit team is going to have a much better knowledge about the company, its strategic direction, where it's going.

The specialist is probably going to have a broader perspective from a market participant observable standpoint. In terms of what would a market participant look like in terms of the inputs and the assumptions.

So typically, you know, if you look at the memos, the specialist will indicate that the audit team will take responsibility for the PFI. But it's really both pieces working together.

If the audit team in terms of the PFI thought it was a little bit more conservative or a little bit more aggressive, you need to talk to the specialist. Because that's going to directly impact what the discount looks like.

So both pieces really do have to come together on that. So, I'm sort of indirectly answering your question here, Marty.

Just in terms of the review and supervision, because both the audit side and on the specialist side, both have to work collaboratively as part of that review and supervision, in order to make sure that those basics are covered.

MR. BAUMANN: Yes. Any further comment on this question of differences or similarities and supervision? Bill, I'll get to you in a second.

MR. PLATT: Yes. I mean the only thing I'll add just in terms of the supervision, is it's clear when it's an employed specialist. You know, we have protocols in place where there are, you know, there are planning documents prepared that would articulate, you know, the responsibilities of the specialists and the responsibilities of the core engagement team.

We do have, similar to what was mentioned before, you know, we have levels of review within our specialist teams where, you know, specialists are reviewing specialist's audit work before it's turned over to the non-specialist, let's say a lead partner in an engagement team.

And so, all those protocols are in place in terms of supervision and review. Honestly, I don't have as much experience and, you know, if we happen to hire Susie's company, you know, come up with a series of valuations for us, that were used by the engagement team.

I don't really have a lot of experience in terms of what then supervision or review we would do of her work and her team.

But, my guess is that it may be much different given the differences between having somebody employed as part of the firm, and somebody who's maybe, I'll put it, outsourced a service to provide a value. But I can't comment specifically on that.

MR. BAUMANN: That's the question we're interested in and a lot of comments on as part of this consultation paper. How different or similar should that level of supervision be for an employed specialist versus an engaged specialist?

I think Dan, your card went up first. And then Susie.

MR. OLDS: Well, I would just like to make a comment, that as a specialist, one of the functions that

I do when I'm working with clients, and whether it's the oil and gas client, or you're talking to their accounting firm.

I may be talking to a lawyer at a law firm. I may be talking to an investment banker. But I'm always cognizant of the fact that I'm probably dealing with something that doesn't have the technical background that I do.

And an important part of my job is to make sure that I communicate with them. And can convey issues that I may see or issues that I have or concerns that I have.

Or things that I think that they need to know. Is what I see as an important part of my job is to make sure that I can convey that to them in a language that they can understand.

MR. BAUMANN: Susie?

MS. DuROSS: I was just going to comment on some of the questions about how the process works. I mean, maybe I wasn't very clear on that in my original statements.

But, generally speaking, the firms that work with us, we do the preplanning --

MR. BAUMANN: The audit firms?

MS. DuROSS: The audit firms that we work with. Which are primarily the second tier and then there's smaller.

And I will say, there is some difference between the two. Within the second tier audit firms, they generally have some valuation experience somewhere in the firm.

So, when they get our prices and our inputs, they generally do two things. They review each of the kinds of securities that we've priced.

So they pull a sample and they collect all of the inputs. And then they review each of those inputs and make sure that they can make sense of those inputs.

They come back to us. They ask questions. You know, sometimes they have a real financial background and a financial experience.

Other times, it's questions that are just common sense. You know, this CLO is rated A and this whole loan is rated BB. Why is this spread, you know, X minus Y?

So, you know, so things that just kind of makes sense. You know, you want to know why one product would trade at a different yield than another.

And those are the follow up questions that we do. The secondary thing that all of our firms do, and we actually suggest, when we run into items that have variances that are outside of our threshold, we reach out to the audit staff, basically the field auditor and we suggest that they collect the inputs.

Most of the firms, well, it's all different. But some of the firms automatically request when that happens that they get the inputs.

And others follow up kind of on an as is basis if it's material or not. And that's entirely up to them.

All of the information that we provide, the auditor is making the final determination. So, you know, they're using our fair value estimates to test the accuracy of their clients'.

So when variances arrive, they really do need to dig in. So, it is kind of a two pronged approach where they're reviewing our procedures generally speaking. And also reviewing when there is variances.

MR. BAUMANN: Is there much variation among the different audit firms and how deep they dig into your work from very extensive to -- assuming a similar risk of material misstatement, how deep they dig into it compared to others?

MS. DuROSS: There is. Some dig very deeply. I think it's, you know, sometimes, you know, how much money and time they have to put into some of these things.

How many SEC clients, SEC issuer clients they have. We don't sell any valuation reports to SEC issuers that don't have a sampling of all of our inputs.

So the size of the sample is entirely up to them. How to choose the sample, it's entirely up to them.

But, that would be a standard. There wouldn't be a firm, no matter what size, that wouldn't get a follow up that we would suggest that they follow up and collect the input sample size.

I think that for the smallest firms, you know, sometimes they don't even have a Bloomberg, they don't have anyway to substantiate the information that we put out there.

So, there's a pretty big difference between, you know, a top second tier firm and the resources that they have with regard to the financial markets. And someone that's much smaller that maybe only has one or two SEC issuer clients.

MR. BAUMANN: Thanks, Susie. Rick, I think you're next on the list. But first, Jay, did you have a follow up on this?

MR. HANSON: I just want to make an observation of some of what I hear here. And I am thinking this is a very different description of what I'm hearing from some of the firm representatives about what happens.

Compared to what Professor Boritz said about the survey of what's actually happening. And it feels like on the one hand, we're hearing the highlight reel. On the other hand, we're hearing the out take clippings.

And I just -- it feels like to me like if we could raise the standard to describe what the highlight reel is describing, as well as, and I'm looking at Joan's spot, she walked out of the room, but do something collectively.

Whether it's PCAOB, whether it's firms, whether it's whatever, to bring the practice on the out takes up to the highlight reel. We'd go a long, long way towards effectiveness.

And we'll never solve this problem. But

addressing the majority of the issues, there are findings from inspections show a fair bit of the out take reel results.

But yet, we do have some that we observe the highlight reels too. So, it's how do we get practice to be evolved more towards the highlight reel that's being described?

MR. BAUMANN: I agree with that. Rick, I said you're next. And you're up.

MR. MURRAY: Thank you, Marty. I'll be as brief as I can. If I were wiser, I'd probably understand whether all my questions have been answered already by other wiser people.

If we start with the assumption that what we're seeking to do here is to improve the quality and the credibility of decision relevant information for investors and other users of financial statements. And that the issue is where can audit standard setting contribute in this area to that process.

I assume there is a kind of unstated assumption that what audit standard setting is capable of doing, is increasing the homogenization of a fairly, disorderly is not a kind word, a fairly incongruent, inconsistent world of activity at the moment in which solutions are sought on an evolving basis.

The key question that I think that the papers raise for us is, what form of regulation would be preferable to go about that? I wonder if we don't also need to add a filter of asking how much regulation.

One contemplates that the sources of messiness in the environment that we're dealing with, are multiple. They lie in the nature of the issue, the way it's shaped, where information bears on evaluation.

How a company goes about doing it substantively and procedurally. What's going on in the expertized market. How it processes. How it connects in both sides of the panels here.

And by the way, I think this has been an excellent set of panel presentations in giving us a real visceral picture of what the challenges are. There is differentiation within the expert community and it's standards and criteria.

And a diversity of approaches within firms by size and by their own protocol. Some, but far from all of that diversity and messiness, is accessible through the ways auditors go about conducting their work and therefore accessible through the audit standard setting process.

The questions that I wonder if we shouldn't also be paying some attention too in the process, are what's capable of being effectively reached through the audit process? Some clearly is.

Also, at what point does the homogenizing benefit of standard setting create a potential adverse consequence of over homogenizing that which is by its nature incapable of responding well to it?

And thirdly, whether those kinds of questions are amenable to a role for economic analysis in trying to measure the net value consequences of what's proposed.

MR. BAUMANN: I think you've summarized some of the big -- some of the challenges in front of us. So, thank you.

But you're right. There's a -- we've heard a lot of very disparate practice. And I think we want to reach the right level in audit standard to narrow that disparate practice.

But yet, let there be some scalability for different risks and different sizes as appropriate. So, I think trying to do all of that within the -- and demonstrate the economic support behind all of that is what's in front of us.

But, we're getting a lot of great input today, I think to do that. So, thanks for your comments.

Andreas, you put your card up. As one of the panelists on one of these questions that jumped up. So I thought maybe you had -- wanted to contribute.

MR. OHL: I think it maybe address a number of the comments. And, you know, I think there's been a lot of discussion about disparity and approach.

And you know, maybe addressing the world that my two panelists operate in, because I don't operate in that space. I really do want to emphasize that where I see the greatest disparity, is not in the audit process that we apply.

It's in my team certainly. It's in the nature of the work that's done in the original appraisal. You know, the scope of what the appraisers engaged to do, can vary pretty substantially.

And sometimes that's a fee question. Sometimes that's a materiality or there could be other considerations that are coming into play.

So, that scope, and a lot of times the variability in scope is really getting to what Bob was talking about, which is how much of that research is being done to identify what are the most appropriate inputs.

And, that's where I see the vast majority of the variability. And then to the extent there's variability in the audit process, it often is basically through the audit process getting the client and the appraiser to go back and do some of those things that I guess we wish they would have done in the first place.

And so, again, whatever -- I don't have a point of view on kind of View A or View B. It's more that I would strongly encourage that whatever construct we come up with, that it addresses the -- what I think is the underlying issue.

Which is the variability and the work that's being done in the first place that's subject to audit. As opposed to the variability in the audit process itself.

MR. BAUMANN: Great. Thank you. Sri?

MR. RAMAMOORTI: Well maybe, but I -- you want me to defer? Okay.

MS. PETERS: I guess, you know, one thing that occurred to me, we chatted about a little bit at my table at lunch. And what I think is really hard for investors, is that we're having this whole dialogue and they -- it's all sort of behind the curtain.

And they don't actually see who the company engaged as a specialist. Nor what the auditor thinks of it.

And I think to decide or to even comment, you know, as I look at how we might comment on this formally, the real question is, it would be hard to ask some investors because they don't know that this is going on. They don't actually see it.

They don't see the problems that the auditors are having. And they don't have insight into that information.

And, but it also concerns me from the profession's perspective, because as I think most people -- most investors would like it the way that Loretta described it this morning, in the sense of they do work, they engage specialists where they feel they need to, and they have auditors who basically reperform the work.

I would guess if I asked, that would be the answer that I would get. But, as she rattled off the size of the balances that were subject to that, it was probably $100 of $150 billion of the assets.

And I think if you told investors that, they would be very surprised that the auditors would have to engage specialists to that degree of the balances associated in particular institutions.

And it goes to a point that Professor Boritz made about sort of the perception of deskilling the profession. And something that Sri made about what's the normative set of skills?

Is it normative accounting in auditing? Or is valuation perceived by investors to be part of the normative skill of accountants and auditors today?

And I think to some degree it is. And there needs to be better articulation or communication to them of what in fact the degree of specialists that's used. And it goes to the conversation this morning of communication of that in the auditor's report.

I think that I've experienced having been an audit partner and having been a preparer, where we've done goodwill valuations at an insurance company. And I've experienced the same thing that Loretta has.

But I've also experienced the scenario that Professor Boritz, in that there's a lack at times of integration of the auditor. That there -- of the specialist, they're considered to be off there.

And it's super important that the language of accounting and the language of finance merge. I just find it really challenging in that how do we comment on this, because I don't think all but even the most sophisticated investors, I'm not certain completely understand the level of work done by specialists, by the company, and probably even more importantly in their eyes, by the auditor.

And I think it's a super -- it's an important part of communicating both by the audit committee and the auditor with investors.

MR. BAUMANN: Thanks Sandy. It's sort of what I heard you say was, right now, investors see a set of financial statements with $150 billion of assets and have no transparency into the fact that the auditors needed the -- didn't have the expertise in a lot of those areas to audit that work themselves.

And needed to such an extensive amount, the assistance of third party -- of specialists, whether employed or engaged, to help them.

And you think that would be important information to investors.

MS. PETERS: I think that they would be very interested in that. And the percentage of fees that were paid to audit the -- I mean, I know we'll never get there.

But I think if you ask them, they'd be like well, how much did we pay for the auditing of those? Because those are the most important things to us.

I worry that the accounting and auditing profession is going to be left with the things that aren't filled with judgment and are the lowest skilled tasks that Professor Boritz, I think there was one point on his skill to that -- or on his slides to that effect.

I think these are the things that investors care most about. They are forward looking. They are the things that set value.

The past transactions are over and done with. And while they're interesting, they're trying to figure out the price for the future.

MR. BAUMANN: How would you as an investor use the information if you found out that the company has $150 billion of assets, specialists were needed to value or to assist the auditor for $100 billion of those assets.

And for $50 billion of those were used management specialist work. And for $50 billion we use our employed specialists?

MS. PETERS: I think that they would perceive these as the greatest risk areas. I think the conversation about ranges and those disclosures about the ranges.

I mean, we said this when we commented back on 157. That's ASC 820 now, I guess, right? That we don't want necessarily sensitivity analysis. But we'd like to range. We'd like a range and where do you sit in that range.

Because they're going to take those numbers and they're going to adjust what they perceive. And they're going to look at where people sit over time.

It's not just is this estimate right. But how straight up is management with me over time in coming up with these that gives management street cred. In that I know that they're always a little conservative or they're always a little aggressive.

And investors make their own assumptions about how they're going to adjust for that.

MR. BAUMANN: Thanks Sandy. Sri, you're up.

MR. RAMAMOORTI: Thanks Marty. I want to go back after hearing all this to my earlier comment. That the distinction between substantive expertise and nominative expertise is actually pretty important.

That's what I'm gathering. And the reason is, it is a substantive expert who leads. The nominative expert is the one who will be taking orders from the substantive expert.

And the substantive expert in our, you know, scenario here is the audit engagement partner, who's ultimately responsible in what works going on there.

I want to draw attention in this regard to what Andreas said about getting a sense of what are the issues by preparing some of these reports yourself, not just review them. Because I think the process of preparation helps you understand how you can go beyond the information given.

But if you just work with the information that's given to you, then I think you become almost lazy intellectually. You're not thinking, you know, what other things might be out there.

But if you prepared it, then yes, you know, you understand all the difficulty with which, you know, you're dealing with.

So all that is leading me to say, back to my question, who is engaging whom for what purpose? So that is the key question here.

Who is engaging whom for what purposes? And what are the structures that we decide? The key criteria there would be the fitness for purpose. How do people get engaged and was the fitness for purpose achieved?

After that, the one other comment I have here is, I was a little concerned with Efrim's characterization of the breakdown in communications between auditors and specialists. And this is a very unfortunate behavioral thing.

Stanford psychologist Leon Festinger has talked to us about the law of social comparisons. And it is very common among human beings to show what is known as disciplinary chauvinism.

I am better then you because I'm intellectually superior. This is very common. And so, you are going to have some fights, absolutely.

And in those fights, what I'm trying to say is, the substantive expert wins. Because they are at the top of the heap. There's no question.

So that's why that distance is important. But I think John Lukomnik's idea of the required communications from auditors to specialists is critical. But I think AS 10 has taken care of that, so that's great.

So I think that's a wonderful, you know, way to try and, you know, resolve some of these issues.

MR. BAUMANN: For at least employed specialists.

MR. RAMAMOORTI: I'm sorry? Oh, I see. I see. Okay. But, there is because here a cultural translation problem here. You know, they don't speak the same language, these folks.

So that's why this required communication is critically important. Because it hopefully resolves the cultural translation issues that might exist between auditors and specialists.

This is my final kind of point here. And why all this discussion is so, so critical as I see it.

So, in the medical profession, there is a very famous lament. The operation was successful, but the patient died. It's very famous. Very well known.

So, it's a real concern, if we aren't careful in this area, there is going to be increased public skepticism about audits. And that's a very dangerous situation to be in.

And so you want to think about this very, very carefully. And so part of this whole initiative should be how do we educate the investing public about, you know, some of this complexity that's, you know, happening, but they aren't privy to it.

They don't understand. Maybe they don't want to understand after we explain. But, you know, I think we should try because it's very important to our profession.

And where it could really go off kilter is with respect to the growing concern opinion, where, going with this, you know, operation was successful kind of comment, we do not want folks to start concluding that every time there is a business failure, obviously there was an audit failure too.

We don't want that conclusion. I mean, obviously it's a wrong conclusion. But it is an inference that would be an unfortunate inference that people will draw.

So, that's all I have. Sorry for being so long in my comments.

MR. BAUMANN: No. That's fine. And a very good comment. And we appreciate that valuable input.

Wally Cooney?

MR. COONEY: Just briefly to respond to the idea that the auditors may -- or investors would be interested in information with respect to how much work's being done by specialists in the audit.

Not to address what's in the auditor's report, but I just wanted to emphasize that management in preparing their financials in MD&A has significant disclosure and discussion about intangibles, impairments, the relative materiality of those.

Pension accounting, to the extent it's significant, the balances related to that, and there are extensive disclosures as well outside of the MD&A, outside of the critical audit matters in the MD&A that are in the footnotes too.

So there is a lot of information in the reports on those particular topics. Not to say that investors might be -- may be interested as well in what the auditor's involvement with those are.

But, more to some of the discussion today. I just wanted to step back and provide sort of my general observations. And I think it's been a great discussion today.

You know, in my view, the standards, whatever's done with 336 and some of the other items we're looking at, I really think they need to be principles-based. I don't think a one size fits all in the current environment with different types of specialists involvement in new areas really will work.

So, I think it should be flexible for different types of items. It should be risk based.

Certainly, I mean, I would support retaining 336 for company engaged specialists, with improvements as desirable. And some of the things we talked about in terms of enhancing communication, certifications, management reps, development of industry, standard frameworks for reporting, I think those can all kind of happen. And be worked on in conjunction with that.

But, I think, you know, where I'm coming from on this is, the two areas where we use specialists a lot is actuaries and business valuations. And while those are challenging areas, and from where I sit, those -- the audit process seems to work fairly well.

And Loretta talked about the process that she goes through. There is a lot of management ownership of these areas. There's a lot of scrutiny and questions and robust review process going on between the auditors.

And so I think with respect to some of these specialists, these areas where specialists have been used for a fairly long period of time, it's generally working. There may be instances to Jay's point where, you know, execution may not be where we want it to be.

I don't think that's really an issue with the standard per se. But, I would not want the end result to be where there's a lot of replication, duplication of work in areas like pension accounting and business valuations that perhaps are properly scoped and are done properly.

We don't -- I don't think we want your auditors engaging specialists to do full-blown valuations and business valuations and full blown actuarial reviews. Those generally seem to be working now.

And I think we want to leverage the work that's being done in those areas. And prioritize audit effort on higher risk areas.

And with respect to specialists, maybe in level three investments, those are the types of areas where maybe additional time and energy needs to be spent.

MR. BAUMANN: Thanks Wally. I see two more -- Rick is your card up from before or again? Thanks.

So I see two cards left up. Liz Murrall and Guy Jubb. And I have to take Liz and Guy and then I'll wrap this session up.

MS. MURRALL: Thank you. Yes, in the UK we've had better insight into the work that's being performed by specialists following the new audit report. And I think that's been very welcome.

But what investors don't -- haven't been able to appreciate or haven't understood, is the extent to which the auditor reviews and oversees that work.

And I was concerned going through the papers to see the difference between the role of the auditor in relation to employed specialists and engaged specialists under 336.

And also now, I'm increasingly concerned to hear about the divergence in practice as to what goes on. And I think it would be very helpful if that was -- could be addressed.

And maybe in the UK going forward, we can have more transparency as to that in the audit report. But I also think it needs to be very clear that the auditor owns this work if it's going into them forming their audit opinion.

And I suppose one of the issues that I had when I was going through the papers, was well, who actually owns, particularly in relation to an engaged specialist, an auditor's engaged specialist, who actually owns those papers?

And can the auditor actually refer to that work in their audit report? Which is their report. And if not, is that something that needs to be addressed?

MR. BAUMANN: Well, the auditor, to the extent they're using the work as part of -- to support their audit effort, they need to have sufficient documentation around that work. Which would include taking papers and a report from the engaged specialist to support their audit opinion.

So the auditor does own the responsibility for that engaged specialist's work. And needs to have in the papers, reports from that engaged specialist or other documentation that would support the work done and the review of that work, consistent with AU 336.

So that's the answer to one of your questions. And as you said, CAMs are a way potentially to disclose.

They have been in the UK I gather, where specialists are being used. And that could be a way to disclose the use of specialists in the United States as well, if we go forward with CAMs.

Guy Jubb, I think you've got the final word on this.

MR. JUBB: Thank you. And I'd like to encourage the PCAOB in its development of these standards to give due weight to the comments by Dr. Boritz in relation to the supervision, coordination and review. The points listed on his slide there.

I do recognize that these are execution issues. But I do believe that they are execution issues that -- in terms of the financial information that comes out of issues.

It is information which the standards should address in terms of ensuring that the auditors for example, Dr. Boritz says auditors may not have the capability to effectively supervise or review the work of the specialist.

And that is something which I think that has to be. It's very important that that should be nailed firmly in the standards.

Bearing in mind that many audit engagement partners, in particular are selected because they are perceived to have sector specialty themselves, special sector expertise. And the ability to recognize failings in this respect may be quite challenging.

And finally, in terms of the disclosures, which were also listed in that slide, I think it is very important to investors that the disclosures are not only appropriate in relation to the financial amounts, but are complete in relation to providing their presentation of the factors that can are attributable to these complex instruments.

Thank you.

MR. BAUMANN: Thanks Guy. Those are good comments. The standards do require today that auditors need to have the specialized skill and understand the industry that they're auditing and sufficiently to perform that audit.

And they also need to have sufficient skill to be able to direct the work of specialists when they use the work of the specialists. And to understand enough about that industry to use their work of specialists.

But, whether there needs to be more specificity around that is one of the things certainly we're exploring here as part of that.

So thanks everybody. And you'll see in the next session, after we come back from break, which will be the continuation of our discussion of our other standards that we're addressing at the same time, auditing and accounting estimates and fair value measures.

Everything we've talked about here around specialists in this discussion goes right to use of specialists in complex estimates and fair value measures. The two projects are really closely wedded together in terms of how we take them forward.

So, when we come back we will talk about the status of our project on auditing estimates and fair value measures. And some of the important decisions left open.

But I think as indicated in our standard setting agenda we put out last March, we will look at potentially bringing these two projects together as we do standard setting. Because it seems to me that specialist project and the estimates project have a very close connection in terms of putting out anything from the PCAOB on this.

I want to thank all of the SAG members again for significant comment and input throughout this entire discussion. That was incredibly valuable to us.

And of course, as you know, there's a transcript of this entire -- I mean, of all of our meetings. And we look at that carefully as we go through and ultimately do the next round of standards settings.

So, thank you for that. And to the panelists, thank you very much for your contribution. Your willingness to join us today and all the value you added.

So, thank you very much. It's 3:25. We should be back by 3:45. That's our goal. Thank you.