

## **Key Observations from Recent CAQ Comment Letters to the PCAOB**

This document summarizes certain key observations from recent CAQ comment letters submitted to the PCAOB. It should not be viewed as all inclusive, and should be read in conjunction with all CAQ comment letters applicable to the related proposals and concept releases.

### **I. Proposed Auditing Standard for Auditing Accounting Estimates, Including Fair Value**

**Measurements (Proposed Estimates Standard):** In response to the PCAOB’s standard-setting project related to auditing accounting estimates, the CAQ has submitted multiple comment letters<sup>1</sup> to the PCAOB. Below is a summary of the comments raised in the most recent [comment letter](#) to the PCAOB on this topic.

#### **a) Objective of the Proposed Estimates Standard**

- The Proposed Estimates Standard includes the explicit objective that estimates be free from bias that results in a material misstatement. This could result in confusion regarding the extent of work intended to be performed by the auditor in accordance with the requirements of the PCAOB’s extant standards related to management bias and the requirements in the Proposed Estimates Standard.

#### **b) Identifying and Assessing Risks of Material Misstatement**

- It is not clear in the Proposed Estimates Standard that auditors would tailor their audit response to an estimate that represents a significant risk versus an estimate that represents a lower risk of material misstatement.
- We question if it improves risk identification to require the auditor to evaluate whether management’s methods are “appropriate for the nature of the related account or disclosure and the **business, industry**, and environment in which the company operates,” as facts and circumstances of a specific accounting estimate may not always be related to the issuer’s industry. Management’s processes and controls are designed to operate at a greater level of precision than the auditor’s materiality and testing thresholds. Due to this difference, it is possible that the auditor’s conclusion as to which assumptions are significant could differ from management’s. If the auditor is able to demonstrate that an assumption is not significant, the auditor should not be required to identify the assumption as significant solely because management did.

#### **c) Valuation of Investments Based on Investee Financial Condition or Operating Results**

- We have concerns with the proposed requirements in Appendix A to Auditing Standard 1105, *Audit Evidence* (AS 1105) in the Proposed Estimates Standard for situations in which the valuation of an investment is based on the investee’s financial condition or

---

<sup>1</sup> See the following CAQ comment letters submitted to the PCAOB on this topic: [Auditing Accounting Estimates Letter](#) (November 3, 2014), [Auditing Accounting Estimates and Fair Value Measurements - A Framework](#) (December 1, 2015).

operating results. The proposed requirements could significantly expand the current requirements for auditors without benefitting audit quality. For many noncontrolling investments, company management may not have direct access to investee management or may not be entitled to such information pursuant to the terms of the investment arrangement to enable the company auditor to perform the proposed procedures. There are often situations where the financial statements of investees are audited under other auditing standards. The Proposed Estimates Standard should not limit the auditor's ability to use audit reports issued in accordance with standards set by other bodies.

**d) Audit Evidence**

- We also raised concerns in our comment letter on the need for clarification of requirements related to third party pricing information, developing an independent expectation of the estimate, and the evaluation of contradictory audit evidence.

**II. Proposed Amendments to Auditing Standards for Auditor's Use of the Work of Specialists**

**(Proposed Amended Specialists Standard):** The CAQ has submitted a prior comment letter<sup>2</sup> to the PCAOB. Below is a summary of the comments the CAQ raised in the most recent [comment letter](#) to the PCAOB on this topic.

**a) Objectivity**

- We support using the term "objectivity" versus the phrase "relationship to the company" for company specialists (employed or engaged). When evaluated appropriately, a specialist's relationship to the company would be considered within the assessment of a specialist's objectivity. Evaluating the degree of objectivity of a company's specialist should be viewed as a continuum that affects the nature, timing, and extent of audit procedures.

**b) Expertise**

- The proposed amendments to paragraphs .B6a and .B8(3) of AS 1105 seem to suggest that the auditor would need to evaluate whether the data was "appropriately" used by the specialist. It is unclear whether this requirement is intended to be similar to paragraph .14 of the Proposed Estimates Standard. The auditor is not expected to have the expertise of a person trained for or qualified to engage in the practice of another profession or occupation and based on auditor judgment, may encounter matters that require such specialized skill. The additional proposed requirements in .B8 that "the auditor should evaluate whether the methods used by the specialists are appropriate and the significant assumptions used by the specialists are reasonable" would require an elevated level of knowledge by the auditor.

---

<sup>2</sup> See the following CAQ comment letter submitted to the PCAOB on this topic: [CAQ Specialists Comment Letter](#) (July 31, 2015).

**c) Requirement for auditors to apply the same auditing procedures to accounting estimates regardless of whether or not management uses an external specialist**

- The Note to paragraph .B8 indicates that the auditor should also comply with the requirements in paragraphs .09 - .18 of the Proposed Estimates Standard, if the company's specialist assisted the company in developing an accounting estimate. We suggest that the nature and extent of procedures should not be the same when a company employed specialist develops an accounting estimate themselves as opposed to when management uses a company-engaged specialist (i.e., an external specialist) that is competent and objective. Furthermore, certain of these procedures may not be practicable given the proprietary nature of certain specialist models or the auditor's lack of sufficient knowledge of the specialist's field to perform all the procedures in these paragraphs. We recommend keeping the principles of extant Auditing Standard 1210, *Using the Work of a Specialist* in regards to this topic.

**d) Communication**

- We support the requirement to "inform the specialist of the work to be performed, which includes establishing and documenting an understanding with the specialist..." The language within Staff Consultation Paper No. 2015-01: *The Auditor's Use of the Work of Specialists* (Consultation Paper), which does not appear to be included in the potential amended standard, suggests that "evidence of the agreement between the auditor and the auditor's specialist might be in the planning memorandum, separate memorandum, audit programs, or other related workpapers." We believe this provides an appropriate amount of flexibility to the auditor and should be explicitly stated within Auditing Standard 1201, *Supervision of the Audit Engagement* (AS 1201).

**e) Smaller Firm Burden**

- We recognize the Proposed Amended Specialists Standard, if approved, could place a significant and possibly disproportionate burden on accounting firms that do not have employed specialists on staff. The PCAOB should also consider this point as it determines the final effective date. The amount of time a firm needs to prepare for the new standard may be different based upon the resources and staffing available and some firms may need more time to prepare for implementation of the proposed changes.

**III. Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors and Proposed Auditing Standard – Dividing Responsibility for the Audit with Another Accounting Firm (Proposed Supervision of Other Auditors Standard):** The CAQ has submitted a prior comment letter<sup>3</sup> to the PCAOB. Below is a summary of the comments the CAQ raised in the most recent [comment letter](#) to the PCAOB on this topic.

---

<sup>3</sup> See the following CAQ comment letter submitted to the PCAOB on this topic: [Supervision of Audits Involving Other Auditors](#) (July 29, 2016).

**a) Lead Auditor Determination**

- ...[T]here could be scenarios where no one auditor would meet the criteria [in determining the sufficiency of participation] of proposed Auditing Standard 2101, *Audit Planning* (AS 2101) paragraph .B2, such as when no individual auditor audits the risks of material misstatement associated with a larger portion of the company's financial statements. The determination of a lead auditor should take into account other qualitative considerations, such as legal and licensing requirements of certain jurisdictions.

**b) Other Auditors' Compliance with Independence and Ethics**

- We have significant concerns related to the implementation of the proposed amendment to AS 2101.B4 to gain an understanding of each other auditor's (1) process for determining compliance with the SEC independence requirements and PCAOB independence and ethics requirements and (2) experience in applying the requirements. Requiring each lead auditor at an engagement team level to gain an understanding of each other auditor's processes (even at the firm level of the other auditor) represents a significant change in existing practice, without a clear understanding of the added benefit. We do not believe such a requirement will necessarily strengthen compliance and could add significant costs. The written representation (premised on consideration of a firm's system of quality control) has an important role to play in considering the independence of the other auditor. Only when there is no such basis for reliance on the system of quality control should the lead auditor consider performing incremental procedures.

**c) Qualifications of and Communication with Other Auditors**

- The PCAOB is considering a new requirement for the lead auditor to inquire about the other auditors' policies and procedures relating to assignment and training of individuals, and gaining an understanding of the knowledge, skill, and ability of the other auditors who assist the lead auditor with planning or supervision. Inquiring about how other auditors assign individuals to audits and train individuals may not be practical for the lead auditor, as such policies and procedures may be considered confidential and proprietary in nature. Gaining an understanding of the knowledge, skill, and ability of other auditors who assist the lead auditor with planning, supervision, or review enables the lead auditor to appropriately vary the extent of supervision.

**d) Lead Auditor Communications**

- We believe communicating all identified risks of material misstatement in all cases is too broad of a requirement. We have a concern that the lead auditor may not always be in a position to identify the complete listing of risks at a location or business unit, and the other auditor should be leveraged in this regard. We suggest modifying the proposed amendments to require communication by the lead auditor of significant matters



identified from discussions with engagement team members of risks of material misstatement as required by Auditing Standard 2110, *Identifying and Assessing Risks of Material Misstatement* paragraphs .49 - .51.

e) **Review of Specified Documentation, including Summary Memorandum**

- Proposed amendment AS 1201.B2c requires the lead auditor to “[d]irect the other auditor to provide for review specified documentation with respect to the work requested to be performed....” We believe that in a risk-based approach, the determination of documentation to be reviewed is determined by multiple factors, including the professional competence of the other auditors and the risks of material misstatement addressed by their work. We request that the PCAOB clarify that there may be certain situations where it is not necessary to obtain specified documentation beyond Auditing Standard 1215, *Audit Documentation* paragraph .19 (such as if the lead auditor determines that the extent of supervision provided is sufficient and they were involved in the planning, execution, and conclusions regarding the procedures performed by the other auditor). It would be useful for the PCAOB to acknowledge that specified documentation obtained by the lead auditor may include a summary of the procedures performed.

f) **Multi-tier audits**

- We believe proposed amendment AS 1201.B3 should not require the lead auditor to obtain, review, and retain the summary memorandum of the second other auditor, unless determined necessary by the lead auditor (e.g., due to risk or other audit matters). If the knowledge, skill, and ability of the first other auditor is not appropriately considered in determining the supervisory approach, the lead auditor may spend time that is unwarranted reviewing the work of a competent second other auditor.