

July 24, 2015

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

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

Dear Office of the Secretary:

This letter is submitted by **BKD, LLP** in response to the solicitation for public comment by the Public Company Accounting Oversight Board (PCAOB or Board) with respect to the Staff Consultation Paper No. 2015-01, *The Auditor's Use of the Work of Specialists*, May 28, 2015.

**BKD, LLP** (BKD) is a national CPA and advisory firm with 34 offices in the U.S. We work with closely held businesses, publicly traded companies, governmental entities, not-for-profit organizations and individuals. BKD and its subsidiaries offer clients a variety of services in accounting, audit and assurance, tax, risk management, technology, corporate finance, forensic and valuation services and wealth management.

We are pleased to provide our observations regarding the potential revisions to PCAOB auditing standards addressed in the Staff Consultation Paper. We agree with the PCAOB's assessment that the use and importance of specialists has increased in recent years, due to additional fair-value requirements and the complexity of business transactions. It is reasonable and appropriate that the PCAOB review and update auditing standards as needed to reflect changing conditions. BKD supports targeted improvements that would be both operational and scalable for all accounting firms.

BKD believes a principle-centered approach that is scalable based on the Board's previously issued Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement*, and auditor's judgment, is important in developing any new or enhanced standard concerning use of a specialist. A principle-based standard allows appropriate adaptation of audit procedures in a dynamic marketplace and recognizes that a specialist's work varies significantly based on the subject matter evaluated. We believe the PCAOB staff should consider which objectives outlined in the Staff Consultation Paper could be accomplished through further clarification of extant standards instead of prescribing new rule-based standards. Previous Staff Audit Practice Bulletins and Staff Questions and Answers have provided meaningful clarifications on how to implement standards, and we encourage the Board to continue providing this type of guidance alongside any enhancement to standards concerning the use of a specialist.

## **Auditor's Specialist**

In the Staff Consultation Paper, the Board proposed two alternative approaches to a new or revised standard on auditor's specialists. The first alternative considers developing a separate standard for using the work of an auditor's specialist.<sup>1</sup> The second alternative proposes to extend the supervision requirements in Auditing Standard (AS) No. 10 to an auditor's engaged specialist.<sup>2</sup> The Board also provides examples of potential amendments to standards, including:<sup>3</sup>

- Evaluating the knowledge and skill of the auditor's specialist
- Enhancements to communication between the auditor's specialist and the auditor
- Reviewing the work and conclusions of the auditor's specialist

We believe the Board's objectives are best accomplished by developing a separate standard for the work of an auditor's specialist. Recently issued standards from the AICPA (AU-C 620) and the IAASB (ISA 620) have provided meaningful enhancements over previous guidance concerning auditor's specialists in their respective jurisdictions. These standards could help improve the PCAOB's efforts to clarify the requirements of auditors when using an employed or engaged specialist without imposing some of the practical difficulties of extending the supervision requirements of AS 10 to an auditor-engaged specialist.

When evaluating the work of an auditor's specialist, we believe auditor-engaged specialists are distinct from auditor-employed specialists, due to limitations in the level of control the auditor can exercise in a nonemployee relationship. Engaged specialists cannot be supervised under the quality control system of the auditor, which inhibits the ability to supervise the work being produced and to access every detailed component of models that often are proprietary. We do not suggest these factors should preclude reliance on audit evidence obtained from engaged specialists. Rather, we suggest that subsuming the guidance into AS 10, even with additional specific guidance, could impose unrealistic requirements on the auditor. We believe the auditor's evaluation of the knowledge and skills of the engaged specialist, evaluation of the inputs provided, agreement on the methods and assumptions used and open communication throughout the audit process are aspects an auditor should consider when determining the level of additional audit evidence needed to reduce audit risk to an acceptably low level.

We are supportive of the Board recommendations enhancing the auditor's responsibility to evaluate the knowledge and skills of an auditor's specialist.<sup>4</sup> Evaluation of an auditor's specialist's professional qualifications, experience and reputation all should be relevant factors

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<sup>1</sup> Page 27 of the Staff Consultation Paper.

<sup>2</sup> Page 28 of the Staff Consultation Paper.

<sup>3</sup> Page 35 of the Staff Consultation Paper.

<sup>4</sup> Page 36 of the Staff Consultation Paper.

influencing an auditor's judgment on the reliability of the information provided by the specialist and determining the nature and extent of additional auditing procedures to be performed.

BKD believes clear and open communication between the auditor and the specialist regarding all relevant terms for the work to be performed is important in ensuring the work of a specialist is appropriate and consistent with the audit's procedures and objectives. We support further clarification and agree that written communication informing the specialist of his or her responsibilities is an appropriate means to initiate an open dialogue between the two parties.

### **Evaluating the Objectivity of an Auditor's Engaged Specialist**

The Staff Consultation Paper proposes two alternatives to evaluating the objectivity of an auditor's engaged specialist. The first extends Rule 2-01 of Regulation S-X to an auditor-engaged specialist, treating a specialist's company as Rule 2-01 treats an "accounting firm" and applying the rules of "covered persons" to analogous roles in the specialist's company.<sup>5</sup> The second alternative would establish a framework to evaluate financial, employment or business relationships between the specialist's company and the client.<sup>6</sup>

We disagree with both proposed alternatives relating to evaluating the objectivity of the auditor's specialist. Engaged specialists, which are outside of the audit firm's quality control system, likely do not have an established independence monitoring system as rigorous as required by public accounting firms. Even if a quality control system is in place to monitor independence, we believe the auditor would have practical difficulties testing the system to obtain adequate assurance that the information produced is reliable.

Applying the requirements of Rule 2-01 of Regulation S-X to engaged specialists raises concerns regarding how the auditor would apply specific defined terms used in the auditing profession to other professionals not familiar with such definitions. We believe it is impractical for an auditor to require a specialist to implement a system to evaluate independence as required by an "accounting firm" or to monitor which professionals are determined to be "covered persons." The resources and efforts of the auditor to evaluate such a system appear to be significant considering the multiple types of specialists engaged. These added costs would appear to be higher for noninternational firms that, for economic reasons, typically engage rather than employ specialists utilized in their audit engagements. Specialists may refuse to comply with either alternative or refuse to accept engagements due to the added costs and constraints. These situations could lead to limitations on the auditor's ability to engage specialists when necessary.

We agree that evaluating the objectivity of the auditor's engaged specialist is an important part of concluding on the specialist's work product. We support further PCAOB clarification on how

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<sup>5</sup> Page 46 of the Staff Consultation Paper.

<sup>6</sup> Page 47 of the Staff Consultation Paper.

objectivity should be evaluated, whether developed in a new standard or enhanced in the extant standard. Examples of potential enhancements include inquiry or written representation from the specialist concerning relationships with the client, as well as discussion about and evidence from systems the specialist has in place to monitor relationships and transactions with current or potential clients.

### **Company's Specialist**

The first alternative proposed in the Staff Consultation Paper regarding standard-setting relating to using the work of a company's specialist would eliminate language from AU 336 that might be construed to limit the auditor's responsibility for the methods and assumptions used in the specialist's work.<sup>7</sup> The Staff also proposed rescinding application of AU 336 to a company's specialists, instead requiring auditors to evaluate evidence provided by a company's specialist similarly to any other evidence provided by the company's management.<sup>8</sup>

We are concerned the proposed alternatives might create a framework where it would be difficult for auditors to rely in any way on the work of a company's specialist. We support additional clarification on the appropriate evaluation of a company's specialists based on the factors mentioned below. We do not believe that standards should preclude an auditor from relying on a company's specialist's work. We believe it is important to recognize and value the knowledge outside of accounting and auditing that specialists contribute to the audit process.

We believe that, when applied appropriately, the extant standard (AU 336) requires the auditor to gain sufficient evidence that the methods and assumptions being used by the company's specialist are reasonable and appropriate. The auditor is required to "evaluate whether the specialist's findings support the related assertions in the financial statements."<sup>9</sup> In this evaluation, the auditor must determine if the work provided by the specialist is reasonable for the circumstances. We believe the auditor's judgment on the nature and extent of additional auditing procedures for evidence provided by management's specialists should vary significantly based on:

- Whether the specialist is employed or engaged by the company
- The department within the company that engages or employs the specialist, *e.g.*, business development or accounting
- The level of oversight by the company and the competence of those overseeing the project

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<sup>7</sup> Page 30 of the Staff Consultation Paper.

<sup>8</sup> Page 32 of the Staff Consultation Paper.

<sup>9</sup> See AU 336.12.

- The evaluation of skills and knowledge of the specialist based upon the criteria outlined in the Staff Consultation Paper<sup>10</sup>
- The objectivity of the specialist, *e.g.*, if engaged, the number of clients the specialist represents and the financial significance of the billings from the company to the specialist
- Degree to which assumptions used by the specialist are supported by verifiable information, *e.g.*, the extent that assumptions can be corroborated in a marketplace, and generally accepted within their field
- Assessment of the appropriateness of the model
- The auditor's risk assessment of the relevant assertions

Requiring auditors to evaluate evidence provided by a company's specialist in a similar way to any other evidence provided by the company's management generally would require the auditor to employ or engage an auditor's specialist to evaluate the company's specialist's work. There are multiple dissimilar situations in which a company's specialists may be utilized in an audit. Based on evaluating the factors listed above, the auditor may conclude an auditor's specialist is needed; however, we believe there are circumstances where utilizing an auditor's specialist does not align with the risk for the relevant assertions. We believe any standard concerning a company's specialists should recognize the importance of the auditor's judgment in determining a risk-based audit approach and be scalable to ensure the appropriate audit procedures are performed to address the level of risk identified.

We agree that enhancements to AU 336 and additional guidance from the PCAOB are needed. We would encourage the Board to consider recent enhancements made by the AICPA for the use of management specialist in AU-C 500 in the Board's standard-setting process.

### **Economic Considerations**

BKD has concerns about potential unintended consequences resulting from the views expressed in the Staff Consultation Paper. If AU 336 is rescinded for use of a company's specialist and the objectivity or supervision requirements for engaged specialists are not scalable based on auditor's judgment, we believe the challenges of complying with new or enhanced standards could result in a *de facto* interpretation of guidance where the only feasible reliance of a specialist comes from those employed by the auditor. Only the largest national firms have the resources and scale to retain the variety of in-house specialists needed for multiple types of complex business transactions. Accounting firms outside the top bracket will be challenged to

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<sup>10</sup> Page 36 of the Staff Consultation Paper.

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economically employ and professionally develop the wide range of specialists needed. Higher audit fees and decreased auditor availability could limit companies' access to capital markets. We recommend that the practicability of complying any new or enhanced standard as it relates to all four classifications of specialists be considered carefully as the Board moves forward in the standard-setting process. We also recommend the economic impact of any proposed new standard be analyzed carefully, especially on accelerated filers, nonaccelerated filers and small reporting companies where a significant portion of the market share of audits are performed by noninternational firms.

BKD supports the PCAOB's endeavors to further audit quality. Additional specificity and clarity around the use of specialists benefits the profession given their increasing importance. The scalability of enhancements to auditing guidance is critical to ensuring a sustainable playing field for all public accounting firms without compromising audit quality. In addition to standard-setting updates, the PCAOB should continue to issue additional guidance when the inspection process reveals consistent departures from the current guidance on the use of specialists.

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We appreciate the opportunity to express our views for the Board's consideration. If you have any questions or would like to discuss these matters further, please contact Doug Bennett at 417.831.7283 or by email at [dbennett@bkd.com](mailto:dbennett@bkd.com) or Peter Kern at 412.364.9395 or by email at [pkern@bkd.com](mailto:pkern@bkd.com).

Sincerely,

A handwritten signature in black ink that reads "BKD, LLP". The letters are stylized and slanted to the right.

**BKD, LLP**