



# CENTER FOR AUDIT QUALITY

*Serving Investors, Public Company Auditors & the Markets*

August 30, 2017

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

## EXECUTIVE DIRECTOR

Cynthia M. Fornelli

## GOVERNING BOARD

Chair  
Cathy Engelbert, CEO  
Deloitte LLP

Vice Chair  
Joe Adams, Managing Partner and CEO  
RSM US LLP

Brian P. Anderson  
Corporate Director

Wayne Berson, CEO  
BDO USA LLP

Jeffrey R. Brown  
University of Illinois College of Business

Lynne M. Doughtie, U.S. Chairman and  
CEO  
KPMG LLP

Stephen R. Howe, Jr., U.S. Chairman and  
Managing Partner, Americas Managing  
Partner, Ernst & Young LLP

J. Michael McGuire, CEO  
Grant Thornton LLP

Barry C. Melancon, President and CEO  
American Institute of CPAs

James L. Powers, CEO  
Crowe Horwath LLP

Timothy F. Ryan, Chairman and Senior  
Partner  
PricewaterhouseCoopers LLP

Mary Schapiro, Vice Chairman Advisory  
Board  
Promontory Financial Group

Re: PCAOB Rulemaking Docket Matter No. 044: *Proposed Amendments to Auditing Standards for Auditor's Use of the Work of Specialists*

Dear Office of the Secretary:

The Center for Audit Quality (CAQ) is an autonomous public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. The CAQ fosters high quality performance by public company auditors; convenes and collaborates with other stakeholders to advance the discussion of critical issues requiring action and intervention; and advocates policies and standards that promote public company auditors' objectivity, effectiveness, and responsiveness to dynamic market conditions. Based in Washington, DC, the CAQ is affiliated with the American Institute of CPAs (AICPA). This letter represents the observations of the CAQ, but not necessarily the views of any specific firm, individual, or CAQ Governing Board member.

The CAQ appreciates the opportunity to share our views and provide input on the Public Company Accounting Oversight Board's (PCAOB or the Board) *Proposed Amendments to Auditing Standards for Auditor's Use of the Work of Specialists* (the Proposal).

Similar to views previously expressed on this topic, which includes our framework,<sup>1</sup> the CAQ applauds the PCAOB's efforts to consider ways to further investor protection by strengthening the requirements for evaluating the work of a company's employed or engaged specialist and applying a risk-based supervisory approach to both auditor-employed and auditor-engaged specialists.<sup>2</sup>

We have organized our detailed observations and suggestions on the Proposal as follows:

- I. General Views
- II. Amendments to PCAOB Auditing Standard 1105, *Audit Evidence* (AS 1105)
- III. Amendments to PCAOB Auditing Standard 1201, *Supervision of the Audit Engagement* (AS 1201)
- IV. Amendments to PCAOB Auditing Standard 1210, *Using the Work of a Specialist* (AS 1210)
- V. Applicability
- VI. Effective Date
- VII. Conclusion

## I. General Views

As noted within the Proposal<sup>3</sup> there are companies across many industries using specialists to assist in developing accounting estimates, interpreting laws, contracts, evaluating characteristics of certain physical assets, in addition to other areas. Our letter will focus on the following areas where we believe additional clarity could be provided for the roles of specialists in the audit. First, we support using the term "objectivity" versus the phrase "relationship to the company." Second, we continue to believe in the core principle that the auditor is not expected to have the expertise of another profession as interpreted from paragraph 12 of AS 1210. Third, a requirement for auditors to apply the same auditing procedures to accounting estimates regardless of whether or not management uses an external specialist could have unintended consequences. Fourth, we would encourage multiple options in the acceptable forms of communications with specialists on work to be performed and those acceptable forms of communication should be explicitly stated within the Proposal. Lastly, we are concerned about the potential consequences of rescinding Audit Interpretation (AI) 11 which deals with the use of legal opinions as audit evidence.

## II. Amendments to PCAOB Auditing Standard 1105, *Audit Evidence* (AS 1105)

*Assessing the knowledge, skill and ability of the company specialist and the specialist's relationship to the company*

We support using the term "objectivity" versus the phrase "relationship to the company" for company specialists (employed or engaged) analogous to the Proposal for auditor-engaged specialists.<sup>4</sup> 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

---

<sup>1</sup> See the comment letter from the CAQ on this topic dated July 31, 2015, <http://www.thecaq.org/pcaob-auditor%E2%80%99s-use-work-specialists>, and *Auditing Accounting Estimates and Fair Value Measurements: A Framework*. Both can be found in the Appendix of the CAQ's comment letter submitted to the PCAOB and publicly available on the [PCAOB's Docket 043](#).

<sup>2</sup> See page 1 of the Proposal.

<sup>3</sup> See page 1 of the Proposal.

<sup>4</sup> See page A1-20 of the Proposal.

be viewed as a continuum that affects the nature, timing, and extent of audit procedures. An auditor may consider, among other things:

- a) Any interests and relationships that create threats to the specialist's objectivity, such as threats relating to self-interest, advocacy, familiarity, self-review, and intimidation, as well as any applicable safeguards, including any professional requirements that apply to the specialist, and evaluation of whether such safeguards are adequate;
- b) Threats to a specialist's objectivity posed by an employment relationship and whether there is any direct reporting by the specialist;
- c) The terms of the agreement to engage the specialist, including whether, and if so, how, the payment structure is tied to a particular outcome;
- d) Whether management has the ability to dictate revisions to the specialist's results before finalization (with or without the agreement of the specialist);
- e) The significance of the relationship between the engaged specialist and management (i.e., whether the specialist has an extensive relationship with management, and whether the fees charged by the specialist are material to the specialist); and
- f) The nature of other services provided by the specialist to the company.

It is our view that while evaluating objectivity, the auditor would evaluate the specialist's relationship with the company and use knowledge of the risks related to the accounting estimate to determine whether additional procedures should be performed with respect to some or all of the specialist's assumptions, methods, or conclusions, including whether the auditor should consider using an auditor's specialist for that purpose.

#### *Using the work of the company's specialists as audit evidence*

Paragraph .B2 of the Proposal states that "the auditor should, in conjunction with obtaining an understanding of the company's information system relevant to financial reporting, obtain an understanding of the work and report(s) of the company's specialist(s) and related company processes and controls." Unless clarified, this could be interpreted that auditors need to evaluate, not just understand, the design of controls in this area in all circumstances even when not relying on those controls. We suggest the phrase "and controls" be deleted and a footnote be included to highlight that this is intended to build upon the requirement in paragraph .28 of PCAOB Auditing Standard 2110, *Identifying and Assessing Risks of Material Misstatement*.

Further, paragraph .B2c indicates that the auditor should understand "the company's process for selecting and using the work of specialists." It is not clear what is meant by "selecting" in this sentence. The statement appears to be referring to the process by which the company chooses one specialist over another. If the specialist selected is objective and competent, explicitly requiring an understanding of the selection process seems unnecessarily prescriptive.

#### *Testing and evaluating the work of the company's specialists*

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 *Proposed Auditing Standard for Auditing Accounting Estimates, Including Fair Value Measurements* (Estimates Proposal). 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.

The Note to paragraph .B8 indicates that the auditor should also comply with the requirements in paragraphs .09 - .18 of the Estimates Proposal, 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 the Proposal keep the principles of extant AS 1210 in regards to this topic.

A requirement for auditors to apply the same auditing procedures to accounting estimates regardless of whether or not management uses an external specialist could have unintended consequences. For instance, if auditors are not able to obtain access to the specialist’s proprietary models, the auditor might need to engage another specialist to develop an independent estimate rather than test the estimate developed by the company’s specialist. Consequently, the company would incur both the costs of engaging a specialist to develop the accounting estimate and the auditor’s costs to engage or employ a separate specialist to develop an independent estimate, with an uncertain increase in audit quality, while placing a significant and possibly disproportionate burden on accounting firms that do not have employed specialists on staff. Those firms may determine that they are unable to engage specialists necessary to their audits that enable them to comply with these requirements, which would limit their ability to continue to audit public companies.

The Proposal<sup>5</sup> provides examples illustrating the necessary audit effort in testing and evaluating the work of specialists. We note that the Oil and Gas impairment analysis, the Allowance for Loan Losses, and the Pension Benefit Obligations examples are often recognized as significant risks already prompting the auditor to do more procedures to gain evidence around the estimates. It is unclear what incremental work would be required to be performed by the auditor as opposed to what is required in extant AS 1105. Providing lower risk examples for contrast would be helpful for the auditor to understand the requirements of the Proposal.

The potential incremental testing outlined above, when coupled with the potential consequences of the suggested requirements in the Proposal regarding the evaluation of an engaged specialist’s relationship to the company could require significant effort, especially in situations where the auditor may not possess the required knowledge or skills related to certain matters encountered in the audit.

### **III. Amendments to PCAOB Auditing Standard 1201, *Supervision of the Audit Engagement* (AS 1201)**

#### *Informing the auditor-employed specialist of work to be performed*

We support the Proposal’s requirement to “inform the specialist of the work to be performed, which includes establishing and documenting an understanding with the specialist...”<sup>6</sup> The language within the Staff Consultation Paper No. 2015-01: *The Auditor’s Use of the Work of Specialists* (Consultation Paper), which does

---

<sup>5</sup> See page A3-19 of the Proposal.

<sup>6</sup> See page A1-18 of the Proposal.

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.”<sup>7</sup> We believe this provides an appropriate amount of flexibility to the auditor and should be explicitly stated within AS 1201.

#### *Use of restrictions, disclaimers, and limitations*

We believe the discussion of restrictions, disclaimers, and limitations in company specialist’s reports (page A3-22 of the Proposal) are equally applicable to situations involving auditor-engaged specialists. Thus, we suggest providing clarity that these same factors may be used by auditors in assessing restrictions, disclaimers, and limitations in auditor’s specialists reports.

#### **IV. Amendments to PCAOB Auditing Standard 1210, *Using the Work of a Specialist* (AS 1210)**

##### *Assessing the knowledge, skill, ability, and objectivity of the auditor-engaged specialist*

The proposed amendments to paragraph .04 of AS 1210 specify the need for the auditor to evaluate an auditor-engaged specialist’s “relationship to the company.” As noted within our discussion of the proposed amendments to AS 1105, a specialist’s relationship to the company would already be considered within the evaluation of the specialist’s objectivity.

An auditor’s engaged specialist is not part of the accounting firm’s training, resource monitoring, or overall system of quality control. Accordingly, in evaluating the objectivity of an auditor’s engaged specialist, the auditor views objectivity as a continuum that, based on the auditor’s judgment, affects the nature, timing, and extent of the auditor’s procedures and the reliability of the specialist’s work as audit evidence. In evaluating the objectivity of an auditor’s engaged specialist, the auditor may:

- a) Obtain information regarding business, employment, and financial relationships between the auditor’s specialist and the company;
- b) Determine, based on an evaluation of that information, whether there are threats to the specialist’s objectivity (e.g., due to an identified relationship between the specialist and the company); and
- c) If threats to the specialist’s objectivity are identified, evaluate the impact of the relationship on the nature, timing, and extent of the audit procedures, taking into consideration whether the relationship has a significant bearing on the ability of the specialist to perform his or her work objectively.

The proposed amendments to paragraph .05 of AS 1210 suggests that the auditor “should not use a specialist who does not have a sufficient level of knowledge, skill, and ability or lacks the necessary objectivity.”<sup>8</sup> Our view is that objectivity should be viewed as a continuum that affects the nature, timing, and extent of audit procedures, based on the auditor’s judgment. Therefore, the standard should acknowledge the importance of auditor judgment and the auditor’s overall risk assessment when evaluating whether a specialist’s objectivity is impaired. As the Proposal is currently written, it appears to remove the ability of the auditor to

---

<sup>7</sup> See page 38 footnote 74 of the Consultation Paper, [https://pcaobus.org/Standards/Documents/SCP-2015-01\\_The\\_Auditor's\\_Use\\_of\\_the\\_Work\\_of\\_Specialists.pdf](https://pcaobus.org/Standards/Documents/SCP-2015-01_The_Auditor's_Use_of_the_Work_of_Specialists.pdf).

<sup>8</sup> See page A1-21 of the Proposal.

apply judgment and additional audit procedures to continue to use the work of the specialist, when certain relationships are identified.

#### *Informing the auditor-engaged specialist of the work to be performed*

Similar to auditor-employed specialists, we support the Proposal's requirement to "inform the specialist of the work to be performed, which includes establishing and documenting an understanding with the specialist..."<sup>9</sup> The language within the Consultation Paper, which is not included in the proposed amendments to AS 1210, 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."<sup>10</sup> We believe this footnote provides an appropriate amount of flexibility to the auditor and should be explicitly stated within AS 1210.

#### *Rescission of AI 11*

The Proposal, if adopted, would rescind AI 11, *Using the Work of a Specialist: Auditing Interpretation of AS 1210*. We do not believe that rescinding AI 11 is appropriate because it provides tailored guidance to assist auditors in evaluating the sufficiency of audit evidence to support management's assertion that a transfer of financial assets has met the isolation criterion of Accounting Standards Codification Topic 860, *Transfers and Servicing*.

The Proposal states that AI 11 reflects outdated accounting requirements and banking regulations. Although AI 11 requires updating to reflect the release of Accounting Standards Update (ASU) 2009-16, *Transfers and Servicing (Topic 860): Accounting for Transfers of Financial Assets*, the ASU did not fundamentally change the de-recognition model in Financial Accounting Standards No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (including the legal isolation assertion) that has been in effect since 2001. Insured depository institutions that have sold financial assets that they intend to de-recognize must continue to obtain legal opinions to support the legal isolation assertion (certain amendments to the Federal Deposit Insurance Corporation's "safe harbor rule" in 2010 notwithstanding). AI 11 provides tailored guidance to assist auditors in evaluating the sufficiency of legal opinions as audit evidence. As an example, the interpretation requires that the opinions be expressed at a "would level," identifying certain qualifications that may call into question whether the legal analysis adequately demonstrates that the assets transferred meet the isolation assertion, and clarifying under what circumstances a substantive consolidation opinion should be obtained for entities subject to the US Bankruptcy Code. Finally, the "auditor reliance" language that appears in paragraph 18 of AI 11 allows an auditor to rely on counsel's opinion, despite the absence of contractual privity between the two.

## **V. Applicability**

We agree with the comments set forth in the Proposal that the proposed amendments could benefit audits of emerging growth companies and brokers and dealers that are required to be conducted in accordance with PCAOB standards. Accordingly, we support applicability of the Proposal to those entities.

---

<sup>9</sup> See page A1-21 of the Proposal.

<sup>10</sup> See page 38, footnote 74, [https://pcaobus.org/Standards/Documents/SCP-2015-01\\_The\\_Auditor's\\_Use\\_of\\_the\\_Work\\_of\\_Specialists.pdf](https://pcaobus.org/Standards/Documents/SCP-2015-01_The_Auditor's_Use_of_the_Work_of_Specialists.pdf).

## VI. Effective Date

We recognize the Proposal, if approved, could place a significant and possibly disproportionate burden on accounting firms that do not have employed specialists on staff. The Board 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.

Audit firms will need to develop and implement training and effective quality control processes to support and facilitate the effective implementation. In order to help ensure smaller firms have sufficient time to prepare, we recommend that the standard be effective for audit periods ending two years after the Securities and Exchange Commission approves the final standard.

## VII. Conclusion

The CAQ is supportive of the Board's development of Proposed Amendments to Auditing Standards for Auditor's Use of the Work of Specialists, and commends the Board and its Staff for advancements made in this important area. The CAQ appreciates the opportunity to comment on the Proposal and would be pleased to discuss our comments or answer any questions that the Staff or the Board may have regarding the views expressed in this letter.

Sincerely,



Cynthia M. Fornelli  
Executive Director  
Center for Audit Quality

cc:

### PCAOB

James R. Doty, Chairman  
Lewis H. Ferguson, Board Member  
Jeanette M. Franzel, Board Member  
Steven B. Harris, Board Member  
Martin F. Baumann, Chief Auditor and Director of Professional Standards

### SEC

Jay Clayton, Chairman  
Michael S. Piwowar, Commissioner  
Kara M. Stein, Commissioner  
Wesley R. Bricker, Chief Accountant  
Julie Erhardt, Deputy Chief Accountant  
Marc A. Panucci, Deputy Chief Accountant  
Sagar S. Teotia, Deputy Chief Accountant