

July 31, 2015

Office of the Secretary of the PCAOB  
PCAOB  
1666 K Street  
Washington DC 20006-2803

[www.pcaobus.org](http://www.pcaobus.org).

Dear Sir or Madam:

This letter documents the comments of Towers Watson on the Staff Consultation Paper No 2015-01 (“SCP”), The Auditor’s Use of the Work of Specialists, as requested in the release of May 28, 2015.

Towers Watson is a global human capital and financial management consulting firm specializing in employee benefits, human capital strategies, and technology solutions. Towers Watson employs approximately 16,000 associates on a worldwide basis, over 1,100 of whom are members of U.S. actuarial bodies. The undersigned have prepared our company’s response with input from others in the company.

We appreciate the opportunity to comment. Note that our comments relate solely to the situation where the specialist involved is a credentialed actuary who is operating as a “specialist engaged by the company” as described in the SCP.

### **Summary**

We respect the role of the auditor and understand the need for guidance on the auditor’s use of the work of a specialist. However, we do not believe that the auditor should need to replicate the work of a credentialed actuary to confirm that the result is reasonable and not materially misstated. The examination and continued education requirements of the U.S. based actuarial organizations<sup>1</sup>, the actuarial standards of practice and Code of Conduct set forth by the U.S. actuarial profession and the professional excellence standards of actuarial firms should provide sufficient evidence to the auditor to confirm the qualifications and objectivity of the actuary, to understand the nature of the work, the assumptions and methods used in the work, and to evaluate the findings of the work.

### **Current Practice**

With respect to the audit of company or benefit plan financial statements, Towers Watson is typically a specialist engaged by the company (i.e., Specialist #3 in Figure 2 of the SCP), most often in the areas of valuations of pension, postretirement and postemployment plans.

Under current practice, the work of our actuaries is typically reviewed by the “specialist employed by the auditor” (i.e., Specialist #1 in Figure 2), generally through responses to audit questionnaires and data

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<sup>1</sup> The American Academy of Actuaries (Academy), the American Society of Pension Professionals and Actuaries, the Casualty Actuarial Society, the Conference of Consulting Actuaries, and the Society of Actuaries.

questions, but also through open dialogue with the auditor or the auditor's specialist. In recent years, we have seen auditors' reviews become significantly more detailed, including more granular review and testing of data and actuarial assumptions to evaluate the reasonableness of the measures produced by the actuary.

### **Auditor Requirements under AU 336**

As described in the SCP, under the current standard (AU 336), when using the work of a company's engaged specialist, the auditor is required to

- Evaluate the professional qualifications of the specialist
- Understand the nature of the specialist's work
- Evaluate the relationship of the specialist to the client, including circumstances that might impair the objectivity of the specialist
- Understand the methods and assumptions used
- Test the data provided
- Evaluate whether the specialist's findings support the financial statement assertions

As described below, we believe the existing qualification and continuing education requirements, and standards of practice of the actuarial profession, should provide the auditor the information and evidence needed to evaluate the work the actuary does for the company. In addition, the quality procedures of the actuary and his or her employer should be taken into consideration in determining the appropriate level of testing needed to support the auditor's evaluation.

#### *Professional Standards*

The U.S. based actuarial organizations provide a robust framework for the ongoing qualification of their members. This begins with a rigorous multi-year examination process and supervised experience period leading to professional designations, and continues with ongoing continuing professional education requirements necessary to sign actuarial communications. Both the actuarial organizations and many actuarial firms, including ours, provide significant opportunities to meet these continuing education requirements with sessions that are relevant to the work actuaries do every day.

Adherence to these qualification standards is monitored by the profession, and information about an actuary's attestation to meeting these requirements is publicly available. The profession also audits a percentage of the attestations each year to confirm compliance with the continuing professional education requirements. The standards of the actuarial profession, as well as the standards of actuarial firms like ours, require that an actuary only perform work that he or she is qualified by education and experience to perform.

#### *Objectivity*

While our firm is engaged by the company, the expectation and intent of both the company and our firm is that the actuary be an objective specialist, leveraging our knowledge and expertise to provide the services the company needs. In addition, our professional standards and firm standards, as well as reputational risk, ensure our objectivity. The risk of losing credentials by not meeting the actuarial profession's standards, or damaging our reputation in the marketplace by having our work not stand up to scrutiny, is more significant than the relationship risk we may face if an individual client does not agree with our work. In addition, our firm's standards significantly limit individual financial investments in our clients.

Our firm's professional excellence standards also ensure our objectivity. Our internal processes require that all work be reviewed by at least two qualified individuals and, in many instances, additional reviews are performed, including review by an experienced actuary with deep expertise in that area but who was not involved in the preparation of the work. We expect other actuarial firms have similar internal standards and protocols in place and would expect the auditor to evaluate those as noted above.

*Nature of the Work*

The actuarial standards of practice regarding communications require disclosure of the purpose of the work we have performed as well as any reliances and limitations the user of the work should be aware of. This information is integral to the deliverable provided to the client as well as the information provided to the auditor.

*Understanding Assumptions and Methods*

Actuarial standards of practice require us to disclose the assumptions and methods used in our work, their sources, and the rationale for any significant assumptions selected by the company, which may or may not be recommended by the actuary based on analysis of data and his or her expertise. In addition, the actuary must make an explicit disclosure if he or she believes that an assumption selected by the company significantly conflicts with what the actuary believes would be reasonable with respect to that individual assumption.

In addition, the actuarial standards of practice regarding communications, which have recently been revised, require significant additional disclosures, including any biases in techniques used, reliance on other parties, and material deviations from the actuarial standards of practice. In addition to the work product, additional information is typically provided as part of the auditor questionnaire. There may also be discussions regarding the assumptions and methods amongst the auditor, the auditor's specialist, the company, and the company's specialist to facilitate the auditor's understanding of the assumptions and methods.

**Expanding the Requirements**

We believe that the proposals in the SCP would result in significant additional cost with no perceptible improvement in the audit evaluation of the work performed by an actuary engaged by the company. The proposed changes seem to require duplication of the work of actuaries and/or significant evaluation of the work of actuaries by non-actuaries. They also would entail audit time spent reviewing complex proprietary valuation systems that require years of development and internal testing by the actuarial firm, and which are generally well beyond the technical expertise of an auditor. Further, some specialists may be unwilling to provide requested detail on proprietary models for business reasons. This could slow down the audit process and deprive companies of specialist services they need – all for no clear benefit.

Our observations regarding the Alternatives for Revising Standards – Company's Specialist are as follows:

We agree that the assumptions used in measuring amounts reported in the company's financial statements are selected by and are the responsibility of the company, not the specialist. As such, we agree with revising AU sec. 336 to eliminate the statement that "the appropriateness and reasonableness of methods and assumptions used and their application are the responsibility of the specialist". We would also observe that actuarial standards of practice require disclosure if the assumptions selected by the client significantly conflict with what the actuary considers to be reasonable for the purpose of the measurement.

We also agree that auditors should evaluate the reasonableness of significant assumptions and appropriateness of methods used by a company's specialist in the same manner as the auditor evaluates information produced by others in the company, and would note that with respect to actuarial valuations, that is already current practice.

However, we are concerned with the proposal to eliminate the provisions that enable the auditor to use the work of the company-engaged specialist if the findings are reasonable. Requiring auditors (or, more likely their employed specialists) to redo and confirm an actuarial valuation performed by an independent actuary (the specialist) is costly and unnecessary given the "reasonableness" checks currently performed by auditors or their specialist actuaries, the rigorous education and qualification standards to become an actuary, and the actuarial standards of practice to which members of U.S. based actuarial organizations

are subject. We also believe the auditor's understanding of the internal quality procedures followed by the actuary should be considered in determining the amount of testing that is appropriate.

We are also concerned about the inference in Question 8 that in order to obtain an understanding of the methods used by the company's specialist, the auditor should have access to the specialist's methods or models at a sufficiently detailed level. While we do not disagree the auditor should have a general understanding of the valuation system, the comment fails to recognize the complexity of actuarial valuation systems, the level of sophistication of the systems development, and the extensive testing performed by technical experts when the system is developed or modified. Importantly, in our firm and presumably other actuarial firms, those developing, testing and using the actuarial valuation system have a detailed understanding of both how the models should operate (i.e., the actuarial science and accounting requirements) and how they are structured. It is unrealistic and an unnecessary duplication of effort for others (whether auditors or their employed or engaged actuaries) to have sufficiently detailed access to those models to "check the work", given the level of both general actuarial and model-specific knowledge needed to do so. In addition, the proprietary nature of models may cause specialists to refuse to provide needed services rather than share what they view to be valuable intellectual property.

We believe that instead the auditor should consider the knowledge, skill, and objectivity of a company's specialist, as well as the quality procedures of the actuary and his or her employer, when evaluating the reliability of information provided by that specialist. In fields for which there are accrediting bodies, standards of practice and continuing education requirements, we believe an auditor should be able to rely on the confirmed competence and objectivity of the specialist, with reasonableness reviews of assumptions, methods and results, but without detailed confirmation or replication of the underlying calculations.

Thank you for this opportunity to comment on the SCP. If you have any questions concerning our comments, please contact us directly.

Sincerely,



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