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PCAOB STAFF CONSULTATION PAPER NO. 2015-01  
THE AUDITOR'S USE OF THE WORK OF SPECIALISTS  
May 28, 2015

The Accounting Principles and Assurance Services Committee (the "Committee") of the California Society of Certified Public Accountants ("CalCPA") respectfully submits its comments on the referenced proposal. The Committee is the senior technical committee of CalCPA. CalCPA has approximately 43,000 members. The Committee consists of 57 members, of whom 43 percent are from local or regional CPA firms, 30 percent are from large multi-office CPA firms, 13 percent are sole practitioners in public practice, 9 percent are in academia and 5 percent are in international CPA firms. Members of the Committee are with CPA firms serving a large number of public and nonpublic business entities, as well as many non-business entities such as not-for-profits, pension plans and governmental organizations.

The Committee has provided responses for each of the questions set forth in the Paper in order to allow the PCAOB Staff to integrate and analyze the comments with those of other respondents. However, we are presenting a summary so that our overall views are clearly set forth.

The Committee believes the PCAOB has not established a compelling need for an exhaustive overhaul of AU Section 336 along the lines suggested by the Paper that is likely to create substantially different audit responsibilities under AU-C Section 620 and ISA 620. Accounting firms have adequately integrated the requirements set forth in AU Section 336 within the broader supervision requirements of AS No 10 to insure the work of the firm's employed or retained specialists or a client's retained specialists who are used to establish critical fair value and other accounting estimates are adequately supervised and reviewed for technical adequacy. The Committee does believe that additional guidance would be useful in (1) evaluating the work of a client's employed specialist as that situation is becoming more frequently encountered in practice, and (2) what constitutes a specialized area of accounting and auditing. That additional guidance could be communicated in the form of supplemental interpretive guidance without the need to withdraw AU Section 336.

For example, the Committee believes the proposed expansion of the requirements to establish the independence of the specialist in accordance with Rule 2-01, or the proposed expansion of the level of inquiry into the methods by which the specialist might be subjected to “threats” to objectivity is wholly unnecessary and will clearly lead to increased audit costs through higher audit fees and fees charged the audit client by the engaged specialist.

## **Current Requirements and Current Practice**

1. Does the information presented in Section III accurately characterize current practice? Are other aspects of current practice – at larger and smaller accounting firms – relevant to the staff’s consideration of potential standard setting in this area?

The Committee believes the information accurately reflects the state of current practice for both large and smaller CPA firms and represents a reasonable starting point for an evaluation of the relevant PCAOB auditing standards.

2. Are there any challenges associated with current practice, especially for those accounting firms that have incorporated the standards of the IAASB or of the ASB into their audit methodologies?

Committee members from the larger firms generally have adopted reasonably consistent audit guidance, programs and checklists related to the use of specialists that are applied to audit engagements performed under both current ASB and PCAOB standards. Committee members have limited experience in performing audit engagements under the IAASB standards. Should the PCAOB significantly revise its standards in a way which more closely aligns the performance standards in evaluating the independence and work of the auditor’s specialist and the company’s specialist, the Committee believes that smaller accounting firms will incur significant training and implementation challenges should the ASB chose not to consider revising its standards in a similar manner. In the interim, it is possible that firms that perform both PCAOB and ASB audits would develop firm guidance regarding the use of specialists using the revised PCAOB standard and apply it to ASB audits as well, since it would represent the then current “best practice”. This will cause an unnecessary increase in audit costs as we discuss in our response to Question 41 below.

3. For accounting firms that use the work of an auditor’s specialist:

a. Does the firm employ or engage those specialists? How does the firm decide to employ versus engage a specialist? For larger firms that employ specialists, are there circumstances when the firm uses engaged specialists? If the firm employs and engages specialists, describe the relevant ways in which each may be used in an audit,

The Committee members note the decision to employ specialists is generally based on two primary considerations: First, is it economically feasible to offer the services performed by the specialists to the accounting firm’s existing or prospective clients, and two, what is the volume of consultation work available from the accounting firm’s existing clientele. If a practice leader can financially grow the specialty practice, it would be justified. For accounting firms with a smaller volume of business for a specialist, it would be more practical and cost effective to hire an outside specialist when the need arises.

Generally, larger firms employ specialists who can perform business valuation and complex equity instrument valuation services. However, actuaries, real estate and other specialty appraisers are more likely to be engaged as needed.

An employed or engaged specialist is generally used on an audit engagement to determine the reasonableness of accounting estimates developed by the client, or it's employed or engaged specialists.

b. Does Figure 1 in Section II.A accurately describe the activities for which the firm uses the work of a specialist? What other specialized knowledge and skill do specialists have and in what areas of the audit is their work commonly used?

The activities set forth in Figure 1 represent the majority of the primary uses for employed or engaged specialists.

c. What type of work do the specialists perform? Does the type of work vary depending on whether the firm employs or engages the specialist? Does the type of work vary depending on the specialist's field of expertise?

As we stated in our response to Question 3.a. above, the primary reason to use an employed or engaged specialist is to test the reasonableness of the client's estimates that require specialized skills not ordinarily possessed by the audit engagement team. For example, the audit engagement team members may have a basic understanding of the process of developing the income approach to valuation, but would use the services of an employed or engaged specialist to evaluate the reasonableness of the "valuation science" applied in determining the reasonableness of the build-up method of determining the discount rate which is applied to the client's cash flow or income forecast. The type of work the specialist would be called upon to perform, under a given set of circumstances related to an audit engagement, would not be expected to change regardless of whether the specialist was employed or engaged.

d. Is the auditor's specialist more likely to assist in testing the company's process or developing an independent estimate? Why?

The answer to this question could depend on the volume of client-related transactions that are encountered in the audit. For example, an investment company or REIT that applies fair value measurements to its primary assets on a recurring basis will require the auditor to evaluate the design and operating effectiveness of the ongoing process applied in developing the fair values as a key internal control, as well as actually testing the reasonableness of such estimates. However, an auditor of another client that infrequently encounters the need to develop a fair value estimate, or where the related fair value estimate is not that material might just focus on developing an independent estimate as a form of substantive test of the client's estimate.

4. For accounting firms that use the work of an auditor's employed specialist:

a. Does supervising the work of employed specialists in accordance with Auditing Standard No. 10 present any challenges?

The Committee's members that employ specialists typically have written firm policies and checklists that are designed to clearly identify the respective role of the specialist and the engagement team members, and to establish the timing of the employed specialist's involvement with the engagement, the employed specialist's budget and other factors. Such guidance generally specifies the audit engagement team takes final responsibility for the conclusions of the specialist (regardless of whether employed or engaged) so do not really present any challenges under current AS No. 10 regarding supervision.

b. How does the firm evaluate whether the work was performed and whether the results of the employed specialist's work support the conclusions reached?

Many firms have a template that sets forth the elements that need to be considered by the employed specialist in the review of client developed estimates. The senior members of the audit engagement team are responsible for reviewing the specialist's report and any underlying calculations for overall reasonableness and to ask any questions as needed. It is also typical during the engagement itself to have the firm's employed or engaged specialist contact the client or client's employed or engaged specialist to directly discuss any issues raised. In this way, the two sets of specialists can work out any differences prior to the audit firm finalizing its conclusion. This process has worked well in the past, and the Committee does not see any obvious flaws in the current application of the AS No. 10 supervision requirement to the work of the firm's employed or engaged specialists.

c. Does this evaluation vary by the nature of the specialization and degree of the auditor's familiarity with that particular specialization?

The engagement partner and accountant in charge are expected to have sufficient industry expertise to be able to understand and evaluate the use of data provided by the client's employed or engaged specialists that are material to the client's financial statements. However, it would be expected that in certain situations such as the need to use the services of an actuary, geologist or lawyer, the degree of evaluation might have to place more reliance on the expertise of the specialist. In an employed specialist role, the engagement team would place reliance on the firm's ability to hire qualified employed specialists

d. How would the evaluation change if the firm engaged the specialist?

In an engaged specialist role, the engagement team would have to possibly expand the evaluation of the engaged specialist's credentials to include references and other means to verify both the skills and independence of the engaged specialist.

e. What is the process for determining whether more senior specialists in the firm, such as partners or principals, should assist the auditor in supervising the work of the specialist? How does that assistance affect the auditor's supervision of the work of the employed specialist?

In many larger firms, a practice leader in the specialty is responsible for the assignment of individual specialists to specific audit engagements based on the nature, complexity and timing involved. In many situations the assigned specialist will submit the preliminary findings to the practice leader or other senior specialist for review before the report is submitted to the

engagement team for their review. In this case, the engagement team shares its overall supervision of the employed specialist with the practice leader or other senior specialist.

5. For accounting firms that use the work of an auditor's engaged specialist:

a. What process does the firm use to assess the knowledge and skill of a specialist before engaging the specialist?

The firm is likely to spend considerable time evaluating the engaged specialist's credentials, past experience and any history of prior employment with the firm, or any of the firm's audit clients in assessing the engaged specialist's knowledge and skills. Many firm's have developed the use of an independence representation template to be used to document the engaged specialist's independence. In many cases, the audit firm may engage a specialist it has worked with on non-audit assignments. Some audit firms may establish a list of preferred specialists for use by engagement teams whose qualifications for specific activities have been previously established. In that case, it would be expected the audit engagement team would document that understanding in the engagement work papers.

b. Are there circumstances when the auditor performs procedures in addition to those specified in AU sec. 336 to evaluate the work of the specialist (e.g., performs procedures similar to those in Auditing Standard No.10)? If so, describe those circumstances and the reasons for using that approach. Do senior specialists in the firm (if any), such as managers and partners, assist in evaluating the engaged specialist's work?

The firm generally considers the detailed requirements specified in AU Section 336 as a subset of the umbrella AS No.10 Supervision of the Audit Engagement standard. AU Section 336 has generally been considered adequate in practice by the firms represented by the Committee as most have developed firm practice aids that specify the roles of in-firm specialists vs. the audit engagement team in allocating responsibilities.

c. How does the firm apply the requirements of AU sec. 336, in conjunction with the risk assessment standards, to the use of the work of an engaged specialist?

Typically firm's audit planning process policy guidelines specifies the early need for identification of the account assertions (such as valuation of derivatives, impairment analyses, etc.) that might require the use of an engaged specialist. If the client has obtained the services of an engaged specialist, the firm would identify the early need to evaluate the qualifications of the engaged specialist. In many, if not most cases, the underlying account assertions (valuation, for example) are likely to be considered as requiring considerable judgment, and therefore, would be considered to be assessed as having higher audit risk. At that point, any in-firm-specialist(s) would be notified, and typically invited to participate in the engagement team discussion regarding developing the overall audit plan.

d. In using the work of an engaged specialist, does the firm have access to all the methods and models of that specialist or are there instances when access to proprietary methods or models is restricted by the specialist or the specialist's employer?

In the Committee's experience, it has found that most engaged specialists will provide access to all underlying valuation methods/models which may supplement their written report, if not included as a direct exhibit to that report. Engaged specialists will generally make themselves

available to respond to any questions posed by the audit engagement team or in-firm specialists.

6. For accounting firms that use the work of a company's specialist:

a. What are the circumstances in which the firm uses the work of a company's specialist? If so, describe the related audit procedures performed in connection with the specialist's work. Are there circumstances when the auditor performs procedures in addition to those specified in AU sec. 336 to evaluate the work of the specialist? If so, describe those circumstances and the reasons for using that approach.

The audit firms will utilize the work of a company's specialist if the client chooses to engage one. Such information is evaluated as would any client-supplied audit evidence considered during the audit process. Many audit firms encourage their audit clients to engage specialists in formulating complex valuation estimates. The audit firm's use AU Section 336 guidance and place particular emphasis in evaluating the independence of the company's specialist. We do note that most, if not all, appraisal and business valuation standard-setters such as the ASA, NACVA and the Appraisal Institute require their members to disclose whether they have any financial or other interest in the client or subject of their opinion of value. The Committee does not have any direct knowledge of the requirements of organizations that other specialists may belong to, such as actuaries, but would assume that disclosure of independence is a benchmark of those organization's professional standards regarding the formation of an opinion and the related report preparation.

b. Does Figure 1 in Section II.A accurately describe the activities for which the auditor uses the work of a company's specialist? Are there other activities in which the auditor uses the work of a company's specialist that should be considered within the scope of this project?

The Committee believes the examples of activities are sufficiently comprehensive for the PCAOB's purposes.

c. In what circumstances has the firm concluded that the findings of the company's specialist were unreasonable and therefore performed additional procedures, as required by AU sec. 336? In those circumstances, what procedures did the auditor perform?

In the event the firm concludes the findings of the company's specialist are "unreasonable" the firm would engage with the client and their specialist to understand the process used, assumptions made, etc. to identify the specific variables that create the difference of opinion. In the experience of the larger firms represented within the Committee, creating a candid and open dialogue under such circumstances will facilitate an acceptable revised result.

d. How does the firm currently apply the requirements of AU sec. 336, in conjunction with the risk assessment standards, to the use of the work of a company's specialist?

The Committee believes its response to question 5.c. above is applicable.

e. Are there any differences between how the firm uses the work of a company's employed specialist and a company's engaged specialist?

Since a company's employed specialist is essentially a member of management and is deemed not to be independent, greater emphasis is placed on documenting and evaluating the employed specialist's background, training and experience. It is also likely, the report or other conclusion of value (if not expressed in a formal report) will be subjected to a higher degree of evaluation as to its technical merits, and possibly reperformance.

### **Potential Need for Improvement**

7. This section provides the staff's views about the need to improve the standards based on issues related to the standards, inspections observations, and the views of the SAG. Do commenters agree with the staff's analysis of the need to improve standards? Are there other issues the staff should consider with respect to this need?

The Committee believes that additional guidance would be useful in evaluating the work of a client's employed specialist as that situation is becoming more frequently encountered in practice. This is noted in situations where private equity firms have expanded their acquisition of operating entities. However, the Committee does believe that the current application of AU Section 336 within the subsequently developed AS No. 10 is not as problematic as set forth in the Paper. The Committee believes that both large and smaller PCAOB registered firms have established sufficient internal guidance to deal with the supervision and review of the work of a firm's employed specialist as well as the evaluation of a client's employed specialist.

8. When an auditor obtains an understanding of the methods used by the company's specialist:

a. If the auditor has access to the specialist's methods (or models), is that access at a sufficiently detailed level (as opposed to a general level, such as a website description) to allow the auditor to obtain sufficient appropriate audit evidence?

The Committee's experience with the described situation has not been problematic for the reasons stated in the Committee's response to question 6.c. above.

b. If the auditor does not have such access, how does the auditor obtain sufficient appropriate audit evidence regarding the relevant assertion?

If the auditor was unable to obtain the information needed to properly evaluate the conclusions expressed by a specialist, and the matter was brought before the client's management and/or audit committee without resolution, it could rise to the level of a disagreement. In the Committee's view such situations would be very rare.

## **Alternative Regulatory Approaches**

9. Are revisions to PCAOB standards the most appropriate way to address the issues as discussed in this staff consultation paper? Are there other alternatives that should be considered?

The Committee believes that revisions to current PCAOB standards should be limited to a consideration of the use of the work of a client's employed specialist. However, the development of implementation guidance to the current AU Section 336, rather than a complete revision, might accomplish the same objective.

10. Should the auditor perform the same procedures when using the work of an auditor's engaged specialist as those required for an auditor's employed specialist?

Essentially yes. However, there is a need to clarify the supervisory role of the auditor's employed specialist. As the Committee stated previously, we understand the larger firms employ partner-level specialists who supervise the work of non-partner specialists. Alternatively, if the auditor's employed specialist was not a partner; an increased supervisory role would have to be undertaken by the audit engagement partner. Emphasis on the independence of the auditor's engaged specialist would need to be considered and carefully documented during the pre-engagement hiring process. The training and ability of the audit engagement partner to perform the supervisory role would also have to be considered.

11. Are there other considerations related to the alternatives presented that the staff should be aware of?

None the Committee is aware of.

12. Are there other alternatives related to the auditor's use of the work of an auditor's specialist that would result in the consistent treatment of the work of an auditor's employed and engaged specialist? If so, explain the other alternatives.

The Committee is not aware of any.

13. Are there any limitations on an auditor's ability to treat the work of an engaged specialist the same way as that of an employed specialist?

The Committee is not aware of any practical distinctions encountered in practice that would be problematic between the two types of specialists.

14. Is it appropriate for an auditor to consider the knowledge, skill, and objectivity of a company's specialist when evaluating the reliability of information provided by that specialist? If so, how might the company's use of the work of a competent and objective specialist under the potential alternatives affect the nature, timing, and extent of the auditor's procedures?

A distinction needs to be made between a company's employed or engaged specialist regarding the inherent lack of independence of the employed specialist. Therefore, potentially more evaluative work is likely to be undertaken under this situation. This distinction ought to be included in any revisions' to the PCAOB's audit standards or other interpretive guidance regarding the use of specialists.



15. How do auditors currently obtain an understanding of the assumptions and methods used by a specialist under AU sec. 336?

The auditor obtains an understanding of the assumptions and methods employed by the specialist by critically reviewing the specialist's documentation underlying the conclusions reached. Verification of any historical financial information used, and establishing the reasonableness of any financial forecasts, etc, must be carefully reviewed and documented. In addition, all critical technical assumptions such as might be employed in developing a test for impairment of goodwill, valuation of a derivative or actuarial calculations must be evaluated for overall reasonableness. It is important in evaluating the reasonableness of the valuation estimate to determine whether the specialist's conclusion falls within a reasonable range. The auditor, or the audit firm's employed or engaged specialist, might undertake a sensitivity analysis using slightly different key assumptions.

16. Should the work of a company's specialist be treated as audit evidence the same way as other information provided by the company? Are there concerns associated with more rigorous testing of the work of a company's specialist that may result from this approach? For example, would auditors increasingly need to employ or engage specialists to perform work to assist the auditor with such testing?

As we previously stated, evaluating the work of a company's employed specialist is likely to require more rigorous testing than the work of a client's retained specialist due to the obvious lack of independence.

17. Are there other alternatives that would be a more appropriate response to the risks of material misstatement in areas where companies use the work of specialists? If so, what are those alternatives?

None the Committee is aware of .

18. Are there any practical concerns with rescinding AU sec. 336? The staff is especially interested in the views of auditors, companies that typically use the work of specialists, and specialists, including those in specialized industries (such as oil and gas and environmental engineering). Are there other challenges associated with testing the work of a company's specialist?

As the Committee stated previously, the core guidance set forth in AU Section 336 has worked in practice. Therefore, other than the need to provide additional guidance in the use of a client's employed specialist, we do not find a compelling need to rescind it.

### **Potential Amendments - Definitions**

19. Are the potential definitions of an auditor's specialist and a company's specialist appropriate? If not, what would be alternative definitions for those terms?

The proposed definitions are considered adequate.

20. Is it appropriate to retain the definition of a specialist from AU sec. 336 or is there a need to update the definition to reflect the increased use of the work of persons with specialized knowledge or skill in accounting and auditing? For example, should that definition also include those with specialized knowledge or skill in income taxes or IT?

The Committee believes that income tax and IT specialists should not be expressly incorporated within a revision of AU Section 336 as their use as employed specialists within accounting firms is closely interwoven with the audit process and the interaction with the audit engagement team. Accounting firms have generally developed sufficiently strong supervisory processes for reviewing the work of income tax and IT specialists, and in considering the work of these specialists within the overall audit process.

21. Is it clear what constitutes a specialized area of accounting and auditing? For example, are persons with specialized knowledge or skill in regulatory compliance (e.g., related to audits of brokers and dealers) considered to be persons with specialized knowledge or skill in accounting and auditing? Should the staff provide clarification about what constitutes a specialized area of accounting and auditing? Does the discussion in this staff consultation paper appropriately describe when third parties may be inside or outside the scope of the potential definition of an auditor's specialist?

The Committee believes that firms which undertake the audit of unique or specialized industries need to have sufficiently developed the needed expertise within the audit engagement team, or through the use of the firm's employed specialists. We do agree that additional discussion regarding this topic of sufficient expertise is relevant to the PCAOB's objectives and should be included.

#### **Potential Amendments – Auditor's Employed or Engaged Specialist**

22. Are the potential requirements to evaluate the knowledge and skill of an auditor's specialist clear and appropriate? Are there other alternatives to accomplish the objectives? Are there other factors that the auditor should consider?

The Committee believes the requirements are clear and appropriate and are consistent with the types of inquiries that are being made in current practice.

23. Are the matters described in the potential requirements on which the auditor and an auditor's specialist should reach an agreement sufficient and appropriate? If not, what other matters should be required to be specified in the agreement before the auditor's specialist performs work to assist the auditor?

The Committee believes the requirements are sufficient and appropriate and are reasonably consistent with current practice.

24. Are there any obstacles to reaching an agreement and documenting all of the categories of information described in the potential requirements? Would it be difficult to comply with some of the potential requirements? Are there other alternatives to accomplish the objectives?

The Committee does not believe there are any significant obstacles that would impact obtaining compliance with the suggested requirements. The Committee notes that external client specialists are generally more than willing to cooperate with the client's audit firm in the process of evaluating their work.

25. Could the potential requirements for informing the auditor's engaged specialist of his or her responsibilities and reviewing the specialist's work and conclusions result in unintended consequences (e.g., tax or employee benefit consequences)?

Not that the Committee is aware of.

26. How do accounting firms determine what information an auditor's specialist should provide to the auditor? Are there circumstances in which auditors may not retain all audit evidence obtained from the specialist?

As the Committee stated in our responses to the prior questions, auditors obtain all relevant information necessary to adequately review the underlying work which supports the specialist's conclusions. The extent and nature of that information varies with the type of conclusion provided by the specialist, how the client utilizes that information in the preparation of its financial statements, and the nature and complexity of the matter. The Committee believes the current requirements of AU Section 336 have not been problematic in practice responding to the evaluation of a specialist's work product.

27. Do the potential requirements appropriately reflect what the auditor's responsibilities should be when an auditor's specialist develops an independent estimate? How would these potential requirements differ from current practice (e.g., for audits performed in accordance with ISA 620 or AU-C Section 620)?

The Committee believes the PCAOB has not established a compelling need for an exhaustive overhaul of AU Section 336 that is likely to create substantially different audit responsibilities under AU-C Section 620 and ISA 620. Potential new requirements for PCAOB audit engagements are suited to the audit of issuers and need not necessarily mirror the AICPA's codified AU-C Section 620. The Committee is not in a position to comment on the relationship to ISA 620 in practice as the Committee's members do not undertake audits under ISA audit standards.

28. Do the potential requirements appropriately reflect what the auditor's responsibilities should be when an auditor's specialist tests the company's methods and significant assumptions? How would these potential requirements differ from current practice (e.g., for audits performed in accordance with ISA 620 or AU-C Section 620)?

Yes. As stated in the Committee's response to Question 27 above, the potential new requirements for PCAOB engagements need not necessarily mirror the AICPA's codified AU-C Section 620. However, there is not a compelling need in the Committee's view to discard AU Section 336.

29. Do the potential requirements appropriately reflect what the auditor's responsibilities should be when the auditor evaluates the results and conclusions of the work of an auditor's specialist? How would these potential requirements differ from current practice (e.g., for audits performed in accordance with ISA 620 or AU-C Section 620)?

Yes, same response as Question 28 above.

30. Do the potential requirements provide appropriate direction for the auditor's consideration of any limitations, restrictions, and caveats in the report of an auditor's specialist?

Yes.

31. Are the potential requirements for evaluating the work of an auditor's specialist appropriate for all types of specialists used in audits (e.g., valuation specialist, actuary, geologist, lawyer, or engineer)? If not, how should the potential requirements be tailored?

The Committee believes the potential requirements are sufficiently flexible to allow for the exercise of professional judgment under varying circumstances. However, including a specific statement to that effect in any proposed new revision or amendment of AU Section 336 would be appropriate.

32. How does the auditor evaluate relationships between an auditor's engaged specialist and a company under AU sec. 336?

The Committee believes an engaged specialist should clearly establish their independence from the audit client. This does not mean the specialist could never have been previously employed as an engagement specialist on behalf of the client. However, as the Committee previously stated, most professional organizations that credential specialists do require the specialist to affirmatively state their independence from the client in their report. Therefore, the auditor would need to carefully evaluate all prior relationships. These inquiries are clearly implied by the current requirements under AU Section 336, but can be clarified under any proposed revision or amendment of AU Section 336.

33. Are the potential requirements under the enhanced objectivity approach for the auditor's use of the work of an engaged specialist appropriate and feasible?

Yes they are.

34. Should the auditor's engaged specialist (and his or her employer) be required to meet the independence criteria of Rule 2-01? Are there certain types of specialists that would not be able to satisfy these criteria? Could these criteria affect the availability of specialists?

The Committee believes this more rigorous requirement bears further study as specialists (as defined) have not previously been defined as "experts" subject to the SEC's strict independence criteria. The Committee believes compliance with Rule 2-01 is beyond the basic needs of the audit process, once the specialist's objectivity has been established under AU Section 336 or the proposed new requirements set forth in the Paper and should not be adopted.

35. Are the potential requirements for the auditor to obtain information regarding business, employment, and financial relationships between the auditor's specialist (including his or her employer) and the company appropriate? If not, should other relevant factors be added to the potential enhanced objectivity requirements? For example, should the potential requirements take into account information barriers or other controls to address conflicts of interest at a specialist's firm?

The Committee considers such inquiries appropriate, as most standard setting bodies that credential specialists provide for the disclosure of such relationships under the organization's reporting standards.

36. Are the potential requirements for the auditor to evaluate the objectivity of an auditor's specialist appropriate? Is it appropriate to apply the reasonable investor test as an overarching principle in assessing the specialist's objectivity? If not, are there other relevant factors that would be helpful to add to the potential requirements? For example, should the potential requirements take into account "threats" to objectivity and "safeguards" to reduce the threats, as provided in ISA 620?

The Committee believes that extending the evaluation of the specialist's independence to include the reasonable investor test as being wholly unnecessary for many of the reasons set forth in the Committee's response to Question 34 above. It would become readily apparent from a review of an engaged specialist's prior work for the audit client whether there were any threats to the basic independence and objectivity requirements already in place under AU Section 336. There is no need to go any further. The Committee is unaware of any situations within its constituent member's experience where an audit client's prior relationship with an engaged specialist was a threat to the specialist's objectivity.

37. Does the enhanced objectivity approach provide sufficient assurance that the work of an auditor's engaged specialist will not be influenced by business, employment, or financial relationships?

As the Committee has previously stated, there is no perceived need in practice for implementing the suggested enhanced objectivity approach.

38. Is the potential requirement that the auditor obtain information about the process used by the auditor's engaged specialist to formulate the responses to the auditor's request for information appropriate and sufficiently clear? If not, are there other relevant factors that would be helpful to add to the potential requirement?

The Committee does not believe the potential requirement to expand the auditor's evaluation of the process used by the engaged specialist to formulate their responses to the auditor's request for information is necessary under the circumstances and will lead to incrementally increased audit costs

39. Does the specialist (or his or her employer) typically have a system in place capable of tracking the information to respond to the auditor's request? If not, could a system feasibly be created?

The Committee believes consideration of such a system is unnecessary in order to establish the independence and objectivity of the specialist and will add to the cost of the audit.

### **Questions Related to Economic Impacts and Implications**

40. For accounting firms that use the work of an auditor's or a company's specialist for public company audits:

a. In how many (*e.g.*, what percentage) of those audits is the work of specialists used? Provide details within the following categories:

- (i) Auditor's employed specialists;
- (ii) Auditor's engaged specialists;
- (iii) Company's employed specialists; and
- (iv) Company's engaged specialists.

The Committee is unable to provide a response to this question based on empirical data.

b. For the auditor's specialists described in a.(i) and a.(ii), what is the ratio of specialist hours to total audit hours?

The Committee is unable to provide a response to this question based on empirical data. However, one of the Committee member's firms (an annually inspected mid-size national firm) reports the following ranges:

- a. Auditor's employed specialists: 5-8%
- b. Auditor's engaged specialists: Less than 5% but not commonly encountered

c. How are the auditor's engaged specialists compensated?

Typically on a specified fixed fee or fee range for the defined assignment.

41. What are the likely economic impacts, including benefits and costs, of the potential alternatives discussed in this staff consultation paper? Are there any unintended consequences not already identified that might result from the alternatives?

The Committee supports a reevaluation of the existing AU Section 336 standard to develop guidance in evaluating the work product of a client's employed specialists but does not consider the need to modify the existing auditing standard with respect to the auditor's employed or retained specialists or an audit client's retained specialists. As discussed in the Committee's response to Question 27 above, we see no compelling need for a comprehensive revision as suggested by the PCAOB Staff. For example, the Committee believes the proposed expansion of the requirements to establish the independence of the specialist in accordance with Rule 2-01, or the proposed expansion of the level of inquiry into the methods by which the specialist might be subjected to "threats" to objectivity is wholly unnecessary and will clearly lead to increased audit costs through higher audit fees and fees charged the audit client by the engaged specialist.

42. To what extent would the potential alternatives help to improve audit quality or reduce the incidence of undetected misstatements, audit deficiencies, and fraud?

The Committee believes the potential alternatives, if fully implemented, will not significantly improve audit quality as the current AU Section 336 standard is reasonably adequate as currently drafted.

43. Would any of the potential alternatives lead to increased cost? If so, what are the estimated (i) number of audits affected and impact on audit hours and cost and (ii) effects on companies' costs?

The Committee is unable to provide a response to this question based on empirical data. However, one of the Committee member's firms (an annually inspected mid-sized national firm) has suggested the imposition of the proposed enhancements to establishing the external specialist's objectivity and independence is likely to impact the majority of the firm's issuer clients (approximately 110) audit engagements by 2-3% and would likely lead to incremental increased costs incurred by the applicable external specialists who bill their client.

44. Do the incremental costs associated with any of the potential alternatives decline as an accounting firm uses specialists more frequently?

Possibly, assuming the same external specialist is employed in successive years.

45. Are the costs of the potential alternatives likely to be reduced in years after the year of initial implementation?

See the Committee's response to question 44 above.

46. Are the economic impacts of the potential alternatives likely to be different for audits involving (i) emerging growth companies, (ii) brokers and dealers, (iii) companies in specialized industries, (iv) companies in certain stages of their life cycles (e.g., development stage), and (v) the use of the work of specialists in specific fields of expertise? If so, provide relevant details.

EGC's typically employ specialists to value derivatives and to develop purchase price allocations under the acquisition method of accounting, among other needs. Thus, the Committee believes audit costs will increase for this group. Brokers and dealers commonly use pricing services as valuation specialists and are also likely to see an increase in audit costs. Companies in the extractive and insurance industries and investment companies (including REIT's) all typically use the work of external specialists and are likely to see an increase in audit costs. Development stage companies engage in substantial stock-based compensation and complex debt/equity transactions requiring the use of valuation specialists, and will see an increase in audit costs. In summary, any company with material fair value estimates will likely face increased audit costs if the majority of the Staff's proposals are ultimately implemented.

47. Are the economic impacts of the potential alternatives likely to affect accounting firms of different sizes differently? If so, provide relevant details. Are there other alternatives that might address the need for improvement noted in this staff consultation paper at lower cost or greater efficiency?

Firms that are large enough to employ specialists will likely experience lower incremental costs, excluding initial year implementation and training. Smaller firms will likely experience greater incremental costs, as they may need to engage a specialist to assist in reviewing the work of the audit client's employed or engaged specialist.

48. As part of considering the need for change, the staff is analyzing academic literature that relates to the auditor's use of the work of a specialist.<sup>104</sup> Is there ongoing research or other information, other than that identified in this staff consultation paper, that the staff should consider in evaluating the economic aspects of changes in standards for the auditor's use of the work of a specialist?

The Committee is unable to respond to this question.

The Committee would be glad to discuss our responses further should the Staff have any questions or require additional information.

Very truly yours,

A handwritten signature in black ink, appearing to read "A.J. Major" with a stylized flourish at the end.

A.J. Major, Chair  
Accounting Principles and Assurance Services Committee  
California Society of Certified Public Accountants