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

**Re: PCAOB Rulemaking Docket Matter No. 043: *Proposed Auditing Standard for Auditing Accounting Estimates, Including Fair Value Measurements***

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

Dear Madam Secretary:

We are pleased to provide comment to the Public Company Accounting Oversight Board (PCAOB or Board) and the staff of the Office of the Chief Auditor (the Staff) regarding the recently issued proposed auditing standard related to auditing estimates, including fair value measurements (Release No. 2017-002), and the related proposed amendments to auditing standards related to the auditor's use of the work of specialists (Release No. 2017-003). As noted in each of these proposals, the standards are closely related and auditors will need to consider both in planning and executing audits where these issues arise. As such we believe it is most efficient for us to comment with one letter addressing our observations in both proposals.

We commend the Staff's efforts in these two areas and believe the final adoption of these standards should improve audit quality. Providing enhanced clarity to the public company auditors enables them to apply their judgment in a reasonable and consistent manner, based on risk assessments and clear guidance. We also are appreciative of the deliberative approach that the Staff undertook in drafting these two standards. The opportunities afforded to stakeholders in the financial reporting process to provide feedback was unprecedented and we believe this model should become the norm for any future standard setting.

Baker Tilly Virchow Krause, LLP (Baker Tilly), is a large regional accounting firm operating primarily in the Midwest and Mid-Atlantic regions. We have approximately 2,700 total staff and 300 partners. We have fewer than 100 issuer audit clients and are a triennially inspected firm. Our issuer practice consists primarily of smaller, non-accelerated filers in various industries, including financial institutions as well as a substantial complement of 11-K audits. Although we are a top 15 ranked firm, our organization is substantially different from a "big four" firm.

Our comments will be in the form of general and specific observations rather than answering the questions posed in the proposals.

### **Proposed Auditing Standard – *Auditing Accounting Estimates, Including Fair Value Measurements***

We agree with the Staff's approach in simplifying the current AS structure, by replacing AS 2501, 2502, and 2503 with one new auditing standard addressing the issues. The existence of three related standards made it difficult for auditors to navigate among the standards to be certain that all the requirements were met. We also appreciate that this proposal finally provides guidance for how the use of pricing services articulates within the two standards. For a smaller firm with a larger financial institution practice, this guidance is very important. Specific comments:

- Appendix 1: Proposed Auditing Standard AS 2501: *Auditing Accounting Estimates, Including Fair Value Measurements*
  - 09: We believe the phrase "free from bias," to be overly broad and appears to be absolutism. Audits are designed to determine whether the financial statements as whole are free from material misstatement, as noted in paragraph .24 of AS 2810. This phrase seems to elevate the concept into a particular measurement(s) in the financial statements. We recommend clarifying this is meant solely in the context of the financial statements as a whole.
  - 10 b: We wonder if this is too narrow a requirement. We agree that the auditor should consider industry practices, when available. But, there may be circumstances where use of another approach may be more appropriate for the issuer. In those cases the auditor should document management's rationale for the departure and consider as part of the risk assessment related to the estimate.
  - 30 b, c: Each of these sub-paragraphs could be interpreted as a presumption that bias always exists in accounting estimates. We recommend inserting the word "potential" before each reference to bias in these sub-paragraphs. We believe these changes are consistent with other PCAOB auditing standards, including AS 1015.09 and the proposed amendment to AS 1015.11. We believe this change is also consistent with the footnote references to AS 2810.24 through .27. Specifically:
    - Sub-paragraph .30b states "...including bias in management's judgments..." with a footnote reference to AS 2810.24 – .26. AS 2810.24 references "potential bias" in the context of the "financial statements as a whole." Similarly, the description of bias in AS 2810.26 is preceded by the word "if."
    - Sub-paragraph .30c states "Evaluating bias in account estimates" with a footnote reference to AS 2810.27. However, AS 2810 includes the words "potential" and "possible" in describing the auditor's evaluation of the presence of bias.

While we have no disagreement with the performance requirements of AS 2810, we recommend the proposed standard in AS 2501 uses consistent language and does not inadvertently extend the auditor's responsibility to determining whether actual bias exists. Determining actual bias requires insight into the intentions of management, which is beyond the scope of auditing. While auditors can assess the appearance of or potential for bias, definitively determining whether bias actually exists could require a forensic examination or behavioral analysis that is beyond the scope of an audit. We believe AS 1015.09 appropriately describes role of the auditor in exercising professional skepticism in an audit.

- Appendix 2: Proposed Amendments to AS 1105, *Audit Evidence*, Appendix A—*Audit Evidence Regarding Valuation of Investments Based on Investee Financial Condition or Operating Results*
  - A2 d: We object to this requirement as it appears to imply that audits conducted in accordance with US GAAS or IAASB audit standards are somehow inferior to PCAOB audits. For many investees this is irrelevant.
  - A4-.A5: Some of the requirements in these paragraphs imply an ability by the investor to obtain direct access to the investee auditor or in some cases the actual books and records of the investee. This in turn implies a level of control being exercised by the investor that may not be the case. We urge the Board to reconsider these requirements.

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

In our previous letter to the Staff commenting on the related Staff Consultation Paper (Comment Letter No. 11), we stated the following, which we continue to believe should be the cornerstone of any new standard addressing the use of specialists:

- Baker Tilly welcomes the Staff Consultation Paper (CP) on AU 336. We agree that the use of specialists has become more prevalent as a result of the need for more complex estimates and fair value measurements in preparing financial statements. We encourage the Staff to carefully consider enhancements to AU 336 but do not agree with rescinding the standard. AU 336 and the principles therein have been a cornerstone of the auditing profession for many years, in particular, the concept contained in paragraph .06 *"The auditor's education and experience enable him or her to be knowledgeable about business matters in general, but 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."* When applied properly, AU 336 enables smaller auditing firms to conduct high quality audits that may include complex measurements and estimates. Therefore any revisions to AU 336 should be made in a way that is operational, sustainable, and scalable for smaller auditing firms. We believe retaining this flexibility in the auditing standard should be an important public policy consideration when the Staff is developing any potential new standard.

Specific comments:

- Proposed Amendments to AS 1105, *Audit Evidence*
  - 08: We strongly agree with the statement in the second bullet about the impact of management's controls on the reliability of evidence generated internally and with the aid of a company's specialist. We recommend that this concept should be directly linked into the risk assessment standards when considering risk related to estimates. A cross reference may be helpful.
  - Appendix B – *Using the Work of a Company's Specialist as Audit Evidence*
    - B4: While we understand this requirement is addressing the objectivity of the company specialist, we believe there are practical limitations as to what exactly an auditor can do beyond inquiry and maintaining an awareness of observing potential indicators as to the lack of objectivity. We also believe that this might be an area where representations by management may be useful and should be required.
    - B5: We also believe there is a practical limit on obtaining evidence related to the company-engaged specialist's competence and objectivity regardless of the importance of the estimate. We suggest that if this is the Board's intent, then some practical guidance on what the auditor could actually do to increase scrutiny in this area should be provided in the proposed auditing standard.

- B6-.B8, Note: We direct the Staff to our comment above. The performance requirements in these paragraphs, in particular the Note to .B6, seem to imply that an auditor may be required to engage or employ a specialist in many cases. This will inevitably lead to a crowding out of smaller firms and potentially lead to a shortage of independent specialists in general. We are not satisfied that there are sufficient numbers of competent specialists in the population to make this requirement operational. We maintain that properly applying the historical approach to company's specialists can and will continue to provide reliable audit evidence. We believe the correct approach is to require the auditor to consider the need for an employed or engaged specialists in situations where management's specialists do not have the required knowledge, skill, and ability or are employing methods or assumptions that are not typical for a particular estimate. In other words if management's specialist is not competent, then auditors may need to consider use of an independent specialist. We believe the Note to .B10 may be the appropriate driver.
- Proposed Amendments to AS 1201, *Supervision of the Audit Engagement*, Appendix C – *Supervision of the Work of Auditor-Employed Specialists*
  - C3-.C4: We believe that a footnote here indicating that an audit firm's system of quality control should be sufficient to ensure compliance with these requirements. That is, there is no need for additional documentation if the specialists are employed by the firm and subject to the quality control system, namely the personnel management component described in QC Section 20 paragraphs .11 through .13.
- Proposed Amendments to AS 1210, *Using the Work of an Auditor-Engaged Specialist*
  - 03: The text of this paragraph is similar to the current text of AS 1210.08, but the proposed wording places the performance responsibility for this assessment on "[t]he engagement partner and, as applicable, other engagement team members..." AS 1210.08 simply refers to "[t]he auditor." We suggest a footnote or other clarification to enable firms to evaluate centrally certain third-party specialists as part of the firm's system of quality control. While some engagement-level analysis of the specialist's knowledge, skill, and ability may be necessary, in many cases, certain specialists are used on a recurring basis by auditing firms and the firm – rather than each individual audit engagement team – may be better positioned to perform this assessment..
  - 04: We believe that there are practical limits on how much an auditor can do with respect to this requirement, beyond obtaining a representation from the specialist as to the matters noted. If the Board's intention is for the auditor to do more, then adding more guidance would be helpful.

That concludes our comments on the two proposals. We appreciate the opportunity afforded us to comment on the proposed auditing standards. We are available for further direct discussion with the Staff if that would be useful to the process.

Sincerely yours,



Baker Tilly Virchow Krause, LLP