American Bankers Association
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Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
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Via website submission: comments@pcaobus.org

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

To Whom It May Concern:

The American Bankers Association[1] (ABA) appreciates the opportunity to comment on the Staff Consultation Paper – *The Auditor's Use of the Work of Specialists* (Consultation Paper). Reflecting the complexity and judgmental nature of many aspects of our industry, banks employ and engage a vast array of specialists. In addition to areas that indirectly impact bank financial statements, such as asset/liability management, credit analysis, and risk management, the use of specialists is pervasive throughout bank financial statements. The Board's Staff Consultation Paper on *Auditing Estimates and Fair Value Measurements*, issued in 2014, heightens the significance of this Consultation Paper as the usage of specialists by banks is frequently related to estimates and fair value measurements. Further, the Financial Accounting Standards Board (FASB) is expected to approve revisions to impairment standards (for loans and debt securities) that will likely increase bank reliance on specialists. Therefore, any revision to the auditing standards related to the use of specialists will have a significant impact on audits of banking institutions.

Cost-effectiveness must be the overriding principle that guides the Board as it evaluates the issues discussed in the Consultation Paper. Both alternatives being considered for revising performance requirements related to the auditor's use of the work of a company's specialists require more rigorous procedures than are currently performed. Although the Consultation Paper notes anecdotal evidence of audit deficiencies related to the use of specialists, it is unclear whether there are problems with the adequacy of the existing standard or compliance with the standard. If it is the latter (and the current standard is not deemed inadequate), auditors will be required to unnecessarily increase audit procedures that will not lead to better audits. If the Board decides to proceed with a formal proposal, we recommend these important guiding principles:

- A formal proposal to revise auditing standards should clarify the systemic problems that the proposal is meant to address. Enforcement of current auditing standards should be considered prior to creating new standards.

[1] The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $14 trillion banking industry and its two million employees.

- The definition of a specialist must be clarified, given the extensive use of specialists within the banking industry.
- Auditing standards should meet the cost-benefit test, looked at holistically, in light of many considerations.
- Standards addressing specialists must be flexible enough for audit firms of all sizes.

These principles are described in more detail below.

A formal proposal to revise auditing standards should clarify any systemic problems that the proposal is meant to address. Enforcement of current auditing standards should be considered prior to creating new standards.

While there may currently be inconsistency in audit practice related to the use of specialists and related procedures around that use, the Consultation Paper does not identify how such inconsistency is leading to material restatements. The Consultation Paper refers to four specific instances in which the auditor's use of the work of a company's specialist contributed to error or fraud (Footnote 45) and generally refers to PCAOB enforcement cases (Footnote 55). However, the cases cited in the Consultation Paper describe the auditors' lack of compliance with existing auditing standard AU sec. 336 in that the auditor did not perform the procedures required under that standard. This standard requires the auditor to, among other things, assess the specialist's qualifications and relationship to the client, make appropriate tests of data provided to the specialist, obtain an understanding of the methods and assumptions of the specialist, and evaluate whether the specialist's findings support the related assertions in the financial statements – all of which are important and reasonable requirements.

Additionally, the Consultation Paper asserts that more rigor may be necessary than is currently required under the standard because the company's specialist may be influenced by the same factors that may cause bias in other personnel of the company who are involved in preparing the company's financial statements. We believe this assumption is unnecessary. Circumstances that might impair the specialist's objectivity are already required to be considered by the auditor, as within AU sec. 336 as noted above. In other words, the real issue is not the need for a new standard, but rather, enforcement of the existing standard should be a focus of the PCAOB.

The definition of a specialist must be clarified, given the extensive use of specialists within the banking industry.

The Consultation Paper lists the following potential definitions:

> Specialist – A person (or entity) with specialized knowledge or skill in a field of expertise other than accounting or auditing. Because income taxes and information technology, as they relate to the audit, are specialized areas of accounting and auditing, this definition does not apply to a person with specialized knowledge or skill in those areas.

> Auditor's specialist – A specialist who performs work to assist the auditor in obtaining sufficient appropriate audit evidence. An auditor's specialist may be either employed by the auditor ("auditor's employed specialist") or a third party engaged by the auditor ("auditor's engaged specialist").
>
> Company's specialist – A specialist who performs work to assist the company in its preparation of the financial statements. A company's specialist may be either employed by the company ("company's employed specialist") or a third party engaged by the company ("company's engaged specialist").

We believe that compliance with (and enforcement of) AU 336 allows for a distinction between the level of work required when a company's specialist is employed by the company, as opposed to when the specialist is merely engaged by the company. Therefore, we believe a distinction in definition is helpful.

Banking institutions use specialists in a broad array of activities.[2] Even when excluding income taxes and information technology, the distinction between a specialist and non-specialist is unclear in regards to many of the specialists used, because work they perform can be directly or indirectly related to preparation of the financial statements, or may otherwise be considered critical aspects of accounting analyses (i.e., classification or measurement). For example:

- Property appraisers are normally involved in the underwriting process, but also can be involved in the measurement of certain assets on the balance sheet.

- Pricing and valuation experts work on an array of fair value measurement services that range from simple data retrieval for level 1 inputs to providing complex proprietary models for level 3 inputs.

- Credit analysts can be involved in the underwriting process, but also can be involved in the classification of certain assets on the balance sheet and in measuring impairment of those assets.

- Work by specialists related to bank asset/liability management is sometimes used to base prepayment assumptions for amortizing loan and security discounts. In the future, the assumptions may be used to estimate loan portfolio lives under the FASB's proposed CECL accounting standard. The portfolio life will be a critical assumption within the CECL standard.

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[2] Banks of all sizes use specialists. Due to increased regulation of the industry as a whole, community banks are finding it more difficult to find and attract employees in various fields. Therefore, we expect the use of both employed and engaged specialists to increase.

- Actuarial consultants: Similar to companies in other industries, actuarial consultants are often used to address key issues in pension accounting and certain insurance-related products.

We are concerned that the effect of the Consultation Paper will be the elimination of specialists because the level of audit work required will be the same, no matter the specialist's employment status. This will be prohibitively costly for banks and smaller auditing firms. We do not believe that this is PCAOB's intent. As a result, ABA recommends that the final definition, rather than focusing on whether the specialists have knowledge in fields "other than accounting", focus on aspects of the activity that may involve specialized professional accreditation and other aspects of quality control.

Auditing standards should meet the cost-benefit test, looked at holistically, in light of many considerations.

Bankers and investors want audits that are *both* reliable and cost-effective. This must be emphasized and explained in any final auditing standard. As previously noted, it appears that the problems noted in the Consultation Paper resulted mainly from noncompliance with the current standard (AU 336) and not from any deficiency in AU 336. Further, we believe that investors in banks understand that the significant issues that require the use of specialists (namely, estimates and fair value measurements) are judgmental in nature. Investors often prefer to use their own assumptions and methods and compare their models to the recorded balance. In these cases, use of specialists and the reasonableness of their methods and assumptions are of little concern to them. Considering these things, in any final proposal on this topic, there must be a better explanation of benefits that will be received as a result of the new standard.

Further, auditors must not consider the work of specialists in a vacuum. They need to analyze this work holistically, considering a full range of factors within their risk analysis. For example:

- The level of work required should be proportionate to the materiality of the related balances being audited. In other words, the level of work should be responsive to risk analysis.

- The level of work should be responsive to regulatory requirements over financial models[3] and the management of 3rd party vendors.[4] Such guidance in the banking industry goes beyond most criteria for internal control effectiveness.

[3] See OCC Bulletin 2011-12 Sound Practices for Model Risk Management -- Supervisory Guidance on Model Risk Management http://www.occ.gov/news-issuances/bulletins/2011/bulletin-2011-12.html

[4] See OCC Bulletin 2013-29 Third Party Relationships – Risk Management Guidance http://occ.gov/news-issuances/bulletins/2013/bulletin-2013-29.html

- The level of work should consider the regulatory examination process that normally provides an independent level of testing for compliance with the requirements just mentioned.

- The level of work should also recognize that, as the level of subjectivity increases in the estimation process (for example, in a fair value measurement or an estimate of the allowance for loan and lease losses), the incremental value of additional procedures to understand the methods and assumptions used by the specialist will often decrease rapidly. This is the nature of auditing estimates.

The new standard must be clear as to "how far does the auditor need to go?" in determining whether to treat the related work, and any underlying data used by the specialist, as though it was produced by the company. The answer to that question will affect how bankers procure such services, as they may naturally seek the most cost-efficient path. This will likely affect community banks and their auditors the most, as the availability of qualified auditing firms and third-party sources are often limited (due to the somewhat specialized nature of the business of banking).

Standards addressing specialists must flexible enough for audit firms of all sizes.

We are concerned about the impact of the requirements on banks of all sizes. We also fear that further requirements put on smaller auditing firms will have an adverse impact on the audits of community banking institutions. Because of increasing complexity of accounting standards that require significant modeling, the use of specialists by both community banks and their auditors has grown over the past several years and is expected to increase over the next several years. In some geographic areas, the universe of available auditors competent to serve community banks is limited. New standards that require additional audit procedures, especially those that essentially disregard the impact of the regulatory examination process, will only serve to unnecessarily add costs to banks and further limit the number of accounting firms that are able to serve them.

Thank you for your attention to these matters and for considering our views. Please feel free to contact me (mgullette@aba.com; 202-663-4986) if you would like to discuss our views.

Sincerely,

Michael L. Gullette