



July 31, 2015

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, D.C. 20006-2803

Dear Board Members:

The Audit and Assurance Services Committee of the Illinois CPA Society (“Committee”) is pleased to comment on the PCAOB’s Staff Consultation Paper No. 2015-01, *The Auditor's Use of the Work of Specialists*, dated May 28, 2015. The organization and operating procedures of the Committee are reflected in the attached Appendix A to this letter. These comments and recommendations represent the position of the Illinois CPA Society rather than any members of the Committee or of the organizations with which such members are associated.

We agree with the Staff’s observations in the Consultation Paper that the use and importance of specialists has increased in recent years, in part due to the increasing complexity of business transactions and the resulting complexity of information needed to account for those transactions.¹ We believe any enhancements to existing auditing requirements and guidance should promote audit quality, be adaptable to changes in the evolving capital markets, and continue to recognize the auditor’s need to use the work of a specialist when situations arise that require specialized knowledge and subject matter expertise not possessed by the auditor.

In this letter, we provide for the Board and Staff’s considerations, our thoughts regarding the topics outlined in the Consultation Paper, including the Staff’s suggested amendments to the related auditing standards. Our letter is organized in the following order:

1. General Thoughts on the Staff’s Consultation Paper
2. Using the Work of an Auditor’s Specialist
3. Using the Work of a Company’s Specialist

The Committee believes that the potential changes in these areas could present challenges that should be considered carefully.

1. General Thoughts on the Staff’s Consultation Paper

The Consultation Paper discusses certain operational challenges related to the auditor’s use of the work of specialists, describes the Staff’s preliminary views concerning the potential need for improvement, and presents potential amendments to PCAOB auditing standards that govern the auditor’s use of the work of specialists in response to the perceived need for improvement. These potential amendments could affect certain aspects (or all) of AU sec. 336, *Using the Work of a Specialist* (AU sec. 336) and certain aspects of Auditing Standard No. 10, *Supervision of the Audit Engagement* (AS10). Although we support the Staff’s consideration of amendments to existing auditing standards, we believe any such amendments related to the auditor’s use of the work of specialists should align with the Board’s risk assessment standards and generally keep the concepts in AU sec. 336 with respect to the work of the specialist, including considering his or her professional qualifications and relationship to the client, and the auditor’s responsibilities when using the findings of the specialist, with certain clarifications and enhancements.

a. Importance of Retaining the Objectives of AU sec. 336

¹ Page 3, the Consultation Paper.



The Consultation Paper presents observations from Board oversight activities that may indicate a potential need for guidance or changes to the auditing standards.² Although we support the consideration of potential changes, we believe such changes would be better accomplished through enhancing, as opposed to rescinding, AU sec. 336. In particular, the Committee believes the essential principle of AU sec. 336 provides the auditor with a fundamental basis for evaluating the work of a specialist, and when applied appropriately, promotes audit quality.³ The auditor's ability to utilize the framework under AU sec. 336 should be maintained and strengthened by certain clarifying enhancements, discussed in detail below.

b. Possible Unintended Consequences of the Potential Amendments

The Staff is seeking comment on two alternative regulatory approaches for how the auditor evaluates the relationship between an auditor's specialist and the company. The two approaches are⁴:

1. Applying the requirements of the Independence Rule in PCAOB standards to engaged specialists; and
2. Applying an approach for an auditor's engaged specialist that would incorporate some but not all elements of the Independence Rule.

We believe that these potential approaches could result in unintended consequences regarding the ability of public accounting firms [of all sizes] to continue to engage specialists, and that the Staff should carefully consider these potential consequences as it evaluates potential amendments to the existing standards. As it relates to the approach to require an auditor-engaged specialist to comply with the requirements of Rule 2-01 of Regulation S-X ("Rule 2-01"), the Committee believes that there are significant unintended consequences to this approach, including that engaged specialists may be unable to comply with the quality control processes and procedures necessary for the evaluation of relationships that might impair that specialist's independence. Also, the availability of auditor-engaged specialists could be reduced and possibly force accounting firms to employ specialists, if they can afford to do so. This will be cost-prohibitive for many public accounting firms, which could eliminate smaller firms from auditing public companies and shift audit market concentration even more unfavorably.

We have concerns about the combined effects of the approaches described above and the potential requirement to evaluate the information provided by the company's specialist in the same manner as information produced by others in the company. Typically, firms other than the largest global accounting firms do not employ specialists, and therefore, rely on engaging specialists to assist in their audit procedures (when engaging an auditor's specialist is considered necessary). Audit quality will likely suffer if the potential amendments, coupled with existing limitations on auditor access to its engaged specialists' proprietary models and methodologies, result in effectively eliminating the opportunity for the auditor to engage a specialist. Accounting firms that engage specialists to support the audit could determine that they are unable to comply with these potential requirements, which could potentially force firms to decide not to engage a specialist and instead direct the engagement team to perform the work, which could have a detrimental effect on audit quality. This also could limit a firm's ability to continue to audit public companies altogether.

2. Using the Work of an Auditor's Specialist

² As noted on Page 23, the Consultation Paper.

³ Paragraph 12, AU sec. 336, "The appropriateness and reasonableness of methods and assumptions used and their application are the responsibility of the specialist [...]."

⁴ As noted on Page 46, the Consultation Paper.



When to use the work of an auditor's specialist in the audit is driven by the auditor's risk assessment process including the complexity of the estimate or fair value measurement, its significance to the audit, and the knowledge, skill, and ability, of the engagement team members.

When an auditor's specialist is employed by the accounting firm, we believe the specialist should continue to be considered a member of the engagement team and be subject to the same supervision and review requirements as any other engagement team member in accordance with AS10. However, we believe the approach to treat an engaged specialist as a member of the engagement team under AS10 may limit an auditor's ability to use the work of an engaged specialist; particularly, the requirement in AS10 for the engagement partner to supervise engagement team members' compliance with PCAOB standards (e.g., Quality Control, Ethics and Independence standards) would be difficult, if not impossible, to apply to an engaged specialist.

a. Evaluating the Knowledge and Skill of an Auditor's Specialist

An auditor's employed specialist is required to follow the firm's system of quality control. This includes a rigorous evaluation of an employee's independence, integrity and objectivity, among other things. This system of quality control requires employed specialists to adhere to a high level of reviews of their knowledge and skills and provides engagement teams deciding to use the work of an employed specialist with the appropriate basis to determine a specialist's objectivity.

When an engaged specialist is utilized, the auditor would need to evaluate the engaged specialist's competency, capabilities, and objectivity. We recommend that this evaluation include consideration of the following (either by inquiry or through other procedures):⁵

- Consider whether the auditor's engaged specialist's work is subject to technical performance standards or other professional or industry requirements (for example, ethical standards and other membership requirements of a professional body or industry association, accreditation standards of a licensing body, or requirements imposed by law or regulation);
- Inquire of the entity and the auditor's engaged specialist about any known interests or relationships that the entity has with the auditor's engaged specialist that may affect that specialist's objectivity;
- Gain an understanding of the auditor's engaged specialist's knowledge and experience of the entity's industry;
- Consider the relevance of the auditor's engaged specialist's competence to the matter for which the specialist's work will be used, including any areas of specialty within the specialist's field; and
- Evaluate the competence of the engaged auditor's specialist with respect to relevant accounting and auditing requirements.

We agree with the Consultation Paper that information regarding the engaged specialist's knowledge and skill can be obtained from a variety of sources, including:⁶

- Experience based on previous work of the specialist;
- Knowledge of the specialist's qualifications, membership requirements of a professional body or industry association, certifications/license or other forms of external recognition;
- Published papers or books written by the specialist; and
- Discussions with the specialist and others who are familiar with the specialist's work.

⁵ The procedures listed are consistent with many included in AU-C 620, paragraphs A16-A21.

⁶ Page 36, the Consultation Paper.



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b. Evaluating the Work of an Auditor's Specialist

We continue to believe that AU sec. 336 provides the auditor with the appropriate basis to evaluate the work of a specialist, whether employed or engaged, and generally support the direction of the potential amendments within the Consultation Paper. However, we are concerned with the potential requirement to evaluate the work of an auditor's specialist differently depending on the testing approach used by the specialist. We believe that when the specialist tests the methods and significant assumptions used by the company, it is appropriate for the auditor to evaluate the specialist's conclusions.⁷ However, we are concerned that the potential requirements for when the auditor's specialist develops an independent estimate would result in the auditor essentially being required to re-perform the work of the specialist.⁸ The potential change will impose a requirement on the auditor that he/she is not qualified to complete. The auditor may not have the background or experience necessary to evaluate whether the methods used by the specialist are appropriate as the specialist was engaged because the auditor wants to involve someone with skills outside of his or her own. We believe the requirements for the auditor in both situations should require only an evaluation of the specialist's conclusions about the items outlined in the potential amendments.

In situations where the audit team believes that the findings of the specialist are unreasonable, the auditor should expand his or her audit procedures to gain additional audit evidence to support the conclusion such as detailed recalculations of the specialist's model, shadow calculations, or sensitivity analyses; alternatively, the auditor should obtain the opinion of another specialist.

c. Evaluating the Objectivity of an Auditor's Specialist

Evaluating the objectivity of an auditor's specialist is an integral part of determining the nature, timing and extent of procedures performed by the specialist and the reliability of the work provided by the specialist as audit evidence.⁹ However, there could be possible limitations on the ability of an auditor to engage a specialist that could arise from the potential amendments regarding the evaluation of the objectivity of an auditor's engaged specialist. Rather than indirectly imposing such restrictions on specialists, we believe that the existing requirements in AU sec. 336 could be enhanced to provide additional specificity around how the auditor evaluates the objectivity of a specialist, as well as how that evaluation affects the auditor's assessment of the reliability of the evidence obtained from the specialist, discussed in detail below.

Rule 2-01 of Regulation S-X

We have significant concerns with the Staff's potential requirement for the auditor's engaged specialist to adhere to this rule. The Consultation Paper recognizes that Rule 2-01 was written primarily for accounting firms and not for organizations, such as specialist entities or individual specialists, who may have considerable challenges in complying with this rule.¹⁰

We believe requiring an auditor's engaged specialist to adhere to the full requirements of Rule 2-01 could impose major limitations on an auditor's ability to engage a specialist willing to implement the appropriate processes and procedures necessary to comply with Rule 2-01. Therefore, the potential amendment could result in specialists not accepting

⁷ As outlined in item b. on Page 40, the Consultation Paper.

⁸ As outlined in item a. on Page 40, the Consultation Paper.

⁹ Paragraph 11, AU sec. 336, states that if the auditor believes the relationship might impair the specialist's objectivity, the auditor should perform additional procedures with respect to some or all of the specialist's assumptions, methods, or findings to determine that the findings are not unreasonable or should engage another specialist for that purpose.

¹⁰ As noted on page 47 of the Consultation Paper.



engagements as the rigors of complying with the SEC independence rule may outweigh the benefits. Further, accounting firms could find it difficult to engage a specialist, which could drive many accounting firms out of the business of auditing public companies. For the largest firms, this might not be a consequence as many of these firms employ specialists.

Enhanced Objectivity Approach

We are in favor of the identification of certain business relationships, financial relationships, or employment relationships that impair a specialist's objectivity. However, we do not think the auditor should obtain information about the process used by the auditor's engaged specialist to formulate responses to the auditor's request for information.¹¹

The requirements under this approach, while not as extensive as discussed above under Rule 2-01, are more than the current requirements under AU sec. 336. The "reasonable investor test" still represents a challenge to assessing the objectivity of a specialist, mainly with respect to the auditor's ability to verify the information required under the enhanced objectivity approach. For example, under this framework, the auditor would be required to obtain and evaluate the processes and procedures used by the specialist to formulate responses to the auditor's request for information. If the specialist's employer does not have processes and procedures in place, it would present challenges for an accounting firm to obtain reasonable assurance about the objectivity of an engaged specialist, including the specialist's employer.¹² ISA 620 could be used as a guide to develop those requirements for the auditor to obtain information as to a specialist's relationships with the client.

3. Using the Work of a Company's Specialist

We believe that the current guidance contained within AU sec. 336 is sufficient to evaluate the work of company employed or engaged specialists and should be retained.¹³ Given the PCAOB's oversight observations, further guidance or clarification may be helpful regarding what steps are considered necessary to obtain sufficient, appropriate audit evidence under the existing standards, rather than concluding that the standard itself is not sufficiently rigorous. One principal comment regarding the Consultation Paper is that it is heavily, if not wholly, focused on considerations related to the use of specialists with respect to accounting estimates such as fair value measurements and forms of valuation. Over the past decade these are the areas in which auditors have vastly improved their knowledge and experience; other areas of specialization (e.g., real estate, cyber issues, environmental concerns) are where auditors lack more depth of knowledge. There are other situations of varying complexity when a specialist may be used. We suggest that the key "specified procedures" related to the auditor's use of the work of company specialists under the existing framework of AU sec.336 be retained, with potential revisions or additional clarification concerning the area of accounting estimates, rather than attempting to apply a "one size fits all" approach to all company specialists.¹⁴

For example, one key area absent from Figure I on page 7 of the Consultation Paper in which accounting firms commonly seek to rely on the work of the company's specialists is in the area of internal investigations, specifically the auditor's evaluation of management's response and the potential impact on the financial statements of matters discussed in AU sec. 317, Illegal Acts by Clients. It is not uncommon for larger, public companies to engage outside counsel, or outside counsel along with forensic accounting specialists engaged by the company through outside counsel, to conduct independent investigations of such matters that come to the attention of management. The auditor's concerns in these matters are more typically in the area of internal controls, management integrity, or disclosure considerations, rather than an evaluation of the assumptions used in a specific model to value an asset or liability.

¹¹ As noted on page 50 of the Consultation Paper.

¹² As noted on page 48 of the Consultation Paper.

¹³ AU sec 336, ¶18 - 12.

¹⁴ As noted on pages 4, 12, and 21-22 of the Consultation Paper.



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The use of company engaged specialists is a best practice in the area of internal investigations. The Consultation Paper suggests that revisions be made that would require the auditor to evaluate the information supplied by the company's specialist in the same manner as the auditor evaluates information produced by others in the company, rather than utilize the "specified procedures" currently included in AU sec. 336.¹⁵ One potential unintended result of revising the level of auditor evaluation of the independent investigators' work, including the requirement to "test information provided by the specialist as if it were produced by the company" may be that companies are discouraged from seeking outside expertise in this important area (or in other key areas beyond valuation where specialists are engaged).¹⁶ The cost of these outside professionals can become quite high but provides significant value to the investor along with a greater assurance of reliability to the auditor, as contemplated by AU sec. 336. Alternatively, should outside specialists continue to be retained, unnecessary duplication of efforts by the auditor of work performed by seasoned, independent professionals may occur which would not provide additional value to the investor. In current practice, we consider the audit firm's evaluation of the specialists work in these matters under paragraphs 8 through 12 of AU sec. 336 to be sufficiently rigorous to ensure a complete investigation has been conducted and to assess the reasonability of the findings.

Companies may also utilize in house counsel and/or human resources personnel to assist with certain investigative type matters, *i.e.*, company employed specialists. In these cases the auditor places heightened emphasis on the current objectivity considerations set forth in AU sec. 336 paragraphs 10 and 11. If the auditor believes the specialist's objectivity might be impaired, the auditor may either suggest to the investigative team additional procedures which could be performed or may consider additional audit procedures be completed by the audit team itself. Requiring the auditor to evaluate the work of company engaged specialists as if it were produced by the company appears to be inconsistent not only with those current objectivity considerations but also with the additional or revised independence considerations set forth in the Consultation Paper.

We agree that under any potential revision, the auditor should continue to be required to evaluate the knowledge, skill, and objectivity of the company's specialist. That evaluation should retain the objectivity considerations currently set forth in AU sec. 336 paragraph 11. However, we believe that: 1) the audit firm's evaluation of the company specialists' work under paragraphs 8 through 12 of AU sec. 336 is sufficiently rigorous to assess the reasonability of the specialist's findings; and 2) the appropriateness and reasonableness of methods and assumptions used should remain the responsibility of the specialist.

The Committee is supportive of the Staff's consideration of developing potential revisions related to the auditor's use of the work of specialists, and commends the Board and its Staff for advancements made in this important area.

The Illinois CPA Society appreciates the opportunity to express its opinion on this matter. We would be pleased to discuss our comments in greater detail if requested.

Sincerely,

Elizabeth J. Sloan, CPA
Chair, Audit and Assurance Services Committee

James R. Javorcic, CPA
Vice Chair, Audit and Assurance Services Committee

¹⁵ Ibid.

¹⁶ As noted on page 24 of the Consultation paper.



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APPENDIX A

AUDIT AND ASSURANCE SERVICES COMMITTEE
ORGANIZATION AND OPERATING PROCEDURES
2015 – 2016

The Audit and Assurance Services Committee of the Illinois CPA Society (Committee) is composed of the following technically qualified, experienced members. The Committee seeks representation from members within industry, education and public practice. These members have Committee service ranging from newly appointed to almost 20 years. The Committee is an appointed senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of audit and attestation standards. The Committee's comments reflect solely the views of the Committee, and do not purport to represent the views of their business affiliations.

The Committee usually operates by assigning Subcommittees of its members to study and discuss fully exposure documents proposing additions to or revisions of audit and attestation standards. The Subcommittee develops a proposed response that is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times includes a minority viewpoint. Current members of the Committee and their business affiliations are as follows:

Public Accounting Firms:

National:

Scott Cosentine, CPA	Ashland Partners & Company LLP
Eileen M. Felson, CPA	PricewaterhouseCoopers LLP
James J. Gerace, CPA	BDO USA, LLP
Michael Hartley, CPA	Crowe Horwath LLP
James R. Javorcic, CPA	Mayer Hoffman McCann P.C.
John Offenbacher, CPA	Ernst & Young LLP
Matthew Rotta, CPA	McGladrey LLP
Elizabeth J. Sloan, CPA	Grant Thornton LLP
Kevin V. Wydra, CPA	Crowe Horwath LLP

Regional:

Jennifer E. Deloy, CPA	Frost, Rittenberg & Rothblatt, P.C.
Barbara F. Dennison, CPA	Selden Fox, Ltd.
Genevra D. Knight, CPA	Porte Brown LLC
Andrea L. Krueger, CPA	CDH, P.C.

Local:

Matthew D. Cekander, CPA	Doehring, Winders & Co. LLP
Lorena C. Johnson, CPA	CJBS LLC
Mary Laidman, CPA	DiGiovine, Hnilo, Jordan & Johnson, Ltd.
Carmen F. Mugnolo, CPA	Trimarco Radencich, LLC
Jodi Seelye, CPA	Mueller & Company LLP
Joseph Skibinski, CPA	Trimarco Radencich, LLC
Richard D. Spiegel, CPA	Steinberg Advisors, Ltd.

Industry:

Matthew King, CPA	Baxter International Inc.
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Educators:

David H. Sinason, CPA	Northern Illinois University
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Staff Representative:

Ryan S. Murnick, CPA	Illinois CPA Society
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