

August 30, 2017

Office of the Secretary
PCAOB
1666 K Street NW
Washington, D.C. 20006-2803
Via email: comments@pcaobus.org

Re: PCAOB Release no. 2017-003
(June 1, 2017), Proposed
Amendments to Auditing Standards
for Auditor's Use of the Work of
Specialists

To the Board:

Harvest Investments, Ltd. thanks the Board for the opportunity to comment on its Release 2017-003, "Proposed Amendments to Auditing Standards for Auditor's Use of the Work of Specialists." Before offering our thoughts on the substance of the release, we would like to express our appreciation for all the work the Board has done in preparing this document, which reflects a substantial engagement with contemporary academic research as well as a commendable integration of previous stakeholder commentary. We think the Board has drawn attention to a number of important issues and challenges, and that it has provided practical and effective guidance for the auditor's use of specialists. We hope our comments prove useful to the Board's deliberations.

Question 1: Does the description of existing audit practice accurately depict the state of practice? Does the discussion of the reasons to improve auditing standards sufficiently describe the nature of concerns arising from the use of the work of specialists that the Board should address? Are there additional concerns that the Board should seek to address?

Harvest agrees that the Board sufficiently describes the nature of concerns arising from the use of the work of specialists. The PCAOB proposal on the use of pricing-service information in the companion release on fair value estimates (Release no. 2017-002) does a good job of addressing the requirements for the use of that information.

In current practice, specialists are used by companies and audit firms principally in "special situations," such as valuing complex derivative investments like employee warrants. These valuations are generally more academic than directly marketplace-oriented. All financial instruments can and should have a tested ASC 820 fair exit value, however, meaning they should have a real price that is derived the way a market player would calculate the price using the same inputs a market participant

would. As the Board is aware and as we state in our value paper¹, the bulk of the capital markets today are valued by pricing services, as was also the case before the crisis; they are not valued by specialists. Among issuers of financial instruments, it is widely accepted that the use of nontransparent prices requires strong internal controls with observable and/or documented inputs in order to avoid (unnecessary) risks to investors. The same standards should apply to audit use.

Question 2: Do these proposed amendments to existing standards appropriately address the reasons to improve the standards discussed above? Are the reasons for having separate standards for using the work of a company's specialist, an auditor-employed specialist and an auditor-engaged specialist clear?

Yes, we find the changes to be clear. We have worked closely with our clients to design deliverables that they can easily use and critically evaluate, in accordance with both existing and proposed specialist rules. While we cannot speak for others, we did not find the practical implementation of such guidance to be burdensome, and we agree that it contributes to investor protection.

Question 3: Are there any other areas of improvement in existing standards relating to audits that involve specialists that the Board should address? Are there related areas of practice for which additional or more specific requirements may be needed?

On page 26, the Board presents data showing that smaller firms do not use a specialist at all 75% of the time. While we view this information with alarm, it nonetheless confirms what we hear from smaller auditing firms.

In practice, both smaller firms and management generally use a pricing service in lieu of a specialist. During the audit process, either a field auditor or their pricing desk will test prices by comparing them with another source. Larger firms often staff the desks with an employed specialist, whereas smaller firms do not. Too often, small auditing firms use the same ultimate source as the issuer - either knowingly or unknowing - and therefore perform no testing at all. Whoever uses a pricing service is acting as a specialist and should be subject to specialist rules.

Question 5: The Board requests comment generally on the analysis of the need for the proposal. Are there additional academic studies or data the Board should consider? The Board is interested in any alternative economic approaches to analyzing the issues presented in this release, including references to relevant data, studies, or academic literature.

The Board has done a tremendous job in keeping abreast of current academic research. We note in passing that at least three of the recent articles cited in the Board's two Releases indicate that

¹ Harvest Investments, Ltd. Comment on PCAOB Release No. 2017-002 (30 August 2017), <https://pcaobus.org/Rulemaking/Pages/docket-043-comments-auditing-accounting-estimates-fair-value-measurements.aspx>

researchers may be starting to move away from treating price as if it were a natural, unproblematic datum.² Each of these articles touches on relations between pricing services and specialists, albeit in different contexts and for different ends. We think researcher inquiry into the manufacture and use of pricing data is very useful, and look forward to seeing more work that deals with these important topics.

Question 7: The Board requests comment generally on the potential costs to auditors and the companies they audit. Are there additional costs the Board should consider?

Harvest agrees with the Board when it states that:

“From a capital market perspective, an increase in investors’ perception of the credibility of information (...) can increase the efficiency of capital allocation decisions.”³

Given that the U.S. fixed-income market is currently valued at \$40 trillion, consistent use of ASC 820-compliant methodologies is a small cost to bear.

Question 14: How much time following SEC approval would audit firms need to implement the proposed requirements?

Harvest has already instituted these new requirements, and the process was neither cumbersome nor expensive.

Question 36: Are the proposed requirements for establishing and documenting the understanding with the auditor-engaged specialist sufficiently clear and appropriate? Would they foster effective two-way communication between the auditor and the auditor-engaged specialist? If not, how could they be changed?

The requirements seem clear and appropriate. In practice, we find that the Board’s focus on the work of specialists has improved communications, to the ultimate benefit of investors.

² Emily Griffith, “Auditors, Specialists, and Professional Jurisdiction in Audits of Fair Values” (March 1, 2015). Available at SSRN: <https://ssrn.com/abstract=2460970>, Glover, Taylor and Wu, “Current Practices and Challenges in Auditing Fair Value Measurements and Complex Estimates: Implications for Auditing Standards and the Academy” in *Auditing: A Journal of Practice and Theory* 36(1) 2/2017 pp. 63-84; Cannon and Bedard, “Auditing Challenging Fair Value Measurements: Evidence from the Field” in *Journal of Accounting* 92(4) 7/2017, pp. 81–114.

³ PCAOB 2017-03, pp. 38-9.

Question 37: To what extent does the proposed requirement for establishing and documenting the understanding with the auditor-engaged specialist represent a change in current practice? What is that change, if any?

These standards indeed represent changes, and we welcome the Board's emphasis on establishing and documenting understanding with auditor-engaged specialists. We find the highlighting of independence and skepticism to be important, just as we valued the PCAOB's emphasis on transparency after the financial crisis. We do not find the proposed changes burdensome and agree that they will improve the financial reporting industry.

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We thank the Board for its time in reviewing our comments. If the Board would find it useful to discuss any of them in more detail, or if it has any additional questions for us related to this Release, please contact Susan DuRoss at 312-823-7051.

With best regards,

Harvest Investments, Ltd.