

July 31, 2015

VIA E-MAIL: comments@pcaobus.org

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

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

Dear Members of the Board and Staff:

Dixon Hughes Goodman LLP ("DHG") welcomes the opportunity to comment on the staff of the Office of the Chief Auditor's (the "Staff") of the Public Company Accounting Oversight Board ("PCAOB" or the "Board") *Staff Consultation Paper No. 2015-01: The Auditor's Use of the Work of Specialists* (the "Consultation Paper").

Headquartered in Charlotte, NC, DHG ranks among the top 20 public accounting firms in the nation, with more than 1,800 professionals and staff in 12 states, and is a member of Praxity, a global alliance of independent firms. This letter includes our views, observations, and recommendations on the Consultation Paper. Our responses are framed by our experiences serving middle-market public issuers and nonpublic broker-dealers, and the potential impact certain alternatives outlined in the Consultation Paper could have on both our client base and similar-sized accounting firms.

Overview

Overall, DHG is generally supportive of the Staff's consideration of developing potential revisions related to the auditor's use of the work of specialists, and commend the PCAOB for developing the Consultation Paper, and holding a special Standing Advisory Group meeting, to solicit stakeholder feedback prior to proposing formal amendments to the auditing standards. We believe certain concepts considered in the Consultation Paper could strengthen audit evidence in the auditor's use of the work of specialists; however, we have reservations regarding some of the alternatives suggested that we believe would significantly increase the efforts (and costs) of an auditor's use of the work of specialists without a commensurate reduction in audit risk.

We also commend the Staff for acknowledging within the Consultation Paper the auditor's ability to use the work of a specialist in situations that require knowledge and subject matter expertise not possessed by the auditor. An auditor cannot be expected to have the expertise of a person trained for or qualified to engage in the practice of a profession not related to accounting and auditing, and the continuation of this general premise is critical to effectively enhancing the existing auditing standards. We believe the ability of the auditor to access such expertise must not be limited to specialists employed by the audit firm. In

our view, certain proposed requirements within the Consultation Paper could diminish an audit firm's ability to utilize engaged specialists, yet provide no demonstrated enhancement to audit quality.

For instance, requiring the auditor to evaluate an engaged specialist similar to an employed specialist (i.e., applying supervision requirements of Auditing Standard No. 10, *Supervision of the Audit Engagement* ("AS 10")) or requiring the auditor's engaged specialist to comply with the provisions of Rule 2-01 of Regulation S-X ("Rule 2-01") could result in significant increases in costs to engage specialists, and potentially reduce the number of specialists willing to be engaged by audit firms. Either outcome would create barriers to audit firms that cannot employ specialists in all professions they may need to access. Such barriers could result in audit firms deciding, or being forced, to exit auditing certain types of public issuers, and could prevent audit firms from enhancing their expertise in existing industries, or limit their ability to develop expertise in emerging industries and markets. We believe such barriers would particularly affect smaller and medium-size audit firms (and their clients) that may face challenges in employing specialists in a wide variety of disciplines.

In addition, although we support the consideration of potential changes to the existing auditing standards, we do not support the Staff suggestions to rescind AU Section 336, *Using the Work of a Specialist* ("AU 336"),¹ and require the auditor to evaluate evidence provided by a company's specialist similar to other evidence provided by the company to the auditor.² AU 336 is built upon a core premise that 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 and, based on auditor judgment, certain matters may require specialized skill or knowledge in order to obtain appropriate evidential matter in the audit.³ This fundamental premise provides a framework for the auditor to evaluate the work of an auditor's engaged specialist or management's specialist (whether engaged or employed) without having to replicate it. Alternatively, we believe AU 336 should be strengthened (not diminished) by supplementing the principles of AU 336 through certain clarifying standard-setting enhancements and the development of application guidance.

We have provided certain comments and recommendations below that we believe will assist the Staff in considering potential enhancements to the auditor's responsibilities regarding using the work of a specialist. In considering our recommendations, as well as recommendations provided by other stakeholders, any amendments to the existing auditing standards should, at a minimum, (i) align with the Board's risk assessment standards, recognizing the relationship between the auditor's risk assessment and the audit procedures designed to sufficiently and appropriately respond to those risks, and (ii) retain the general concepts in AU 336 to continue to allow, and not limit, the auditor's ability to utilize specialists in instances where the auditor lacks the expertise of a person trained for or qualified to engage in the practice of another profession or occupation.

Use of an Auditor's Specialist

Extension of the Auditor's Supervisory Requirements

The Consultation Paper contemplates a potential extension of the supervision requirements of AS 10 to engaged specialists, which would integrate an engaged specialist into the engagement team, and require

¹ Page 32, the Consultation Paper.

² Ibid.

³ Paragraph 6, AU 336.

the auditor to supervise and evaluate the specialist's compliance with PCAOB standards (e.g., Quality Control, Ethics and Independence standards) consistent with other members of the engagement team.⁴

We acknowledge the auditor's responsibility for assessing the qualifications and objectivity of the specialist and believe that AS 10 provides appropriate requirements regarding the auditor's responsibilities to supervising the audit engagement, including supervising of the work of the auditor's employed specialist. However, we do not believe it is appropriate (or practical) to expand these supervisory requirements to an auditor's engaged specialist. There are recognized differences between an employed specialist, who is considered an employee of the audit firm, and an engaged specialist, who is essentially a contractor specifically engaged to provide specialized services and skills to the audit and not considered a member of the audit engagement team, and therefore, not subject to the audit firm's system of quality control. Further, an engaged specialist typically maintains their own internal systems, models, and data to assist in developing or assessing the specialist's work product or conclusions. Some of these systems, models, and data may be proprietary to the specialist or otherwise not accessible to the auditor. Therefore, it is unclear how the auditor would be able to provide supervision consistent with the requirements of AS 10 to an engaged specialist.

We believe these differences are important in determining the auditor's supervisory responsibilities, and such differences have been acknowledged by other international auditing standard-setters (i.e., the International Auditing and Assurance Standards Board). Therefore, rather than extend the supervisory requirements of AS10 to the auditor's engaged specialist, we believe it is more appropriate to acknowledge within the auditing standards that an engaged specialist is not a member of the engagement team and develop supervisory responsibilities that take into account this general premise. For instance, the Staff could consider a framework similar to International Standard on Auditing No. 620, *Using the Work of an Auditor's Expert* ("ISA 620"), which specifically acknowledges that an auditor's external expert (i.e., engaged specialist) is not a member of the audit team and therefore not subject to the audit firm's quality control policies and procedures,⁵ and requires the auditor to take this into consideration in determining the nature, timing, and extent of audit procedures in using the work of an external specialist.⁶

Evaluating the Knowledge and Skill of the Specialist

The Staff is considering within the Consultation Paper whether specific enhancements are needed to improve the auditor's evaluation of whether an auditor's specialist (whether engaged or employed) has the necessary knowledge and skill to perform the assigned tasks related to the audit.⁷ These potential requirements would expand upon the auditor's current responsibilities under AU 336⁸ to evaluate the professional qualifications, experience, and reputation and standing of an auditor's specialist, and are generally consistent with ISA 620 and AU-C Section 620: *Using the Work of an Auditor's Specialist* ("AU-C 620").⁹

⁴ Page 28, the Consultation Paper.

⁵ Paragraph A12, International Standard on Auditing 620, Using the Work of an Auditor's Expert.

⁶ Paragraph 8(e), ISA 620.

⁷ Page 36, the Consultation Paper.

⁸ Paragraph 8, AU 336.

⁹ Footnote 73, Consultation Paper.

We agree with, and generally support, the Staff's suggested enhancements to evaluating the knowledge and skill of an auditor's specialist (whether employed or engaged), and believe these enhancements are generally consistent with ISA 620 and AU-C 620. However, the Staff's suggestion in evaluating the knowledge and skill of an employed specialist that, "*the auditor may take into account information available from the accounting firm (e.g., information contained in the firm's quality control system, results of internal and external inspections, and results of the firm's performance reviews)*"¹⁰ may imply that an auditor is obligated to prepare a performance evaluation any time a specialist is utilized on an audit engagement, rather than rely on the evaluation(s) of the specialist contained in the firm's system of quality control. Further, the suggested linkage to inspection results (both internal and external) could imply that the auditor's evaluation of the knowledge and skill of the specialist should be narrowly focused on inspection considerations.

We believe, in instances where the specialist is subject to the audit firm's system of quality control (i.e., employed specialist), unless information provided by the audit firm or other parties suggest otherwise,¹¹ the auditor's evaluation should be based on information contained within the firm's system of quality control. However, the auditor is still required to evaluate whether an auditor's specialist (whether employed or engaged) has the necessary knowledge and skill, and we believe ISA 620 provides an appropriate basis for this evaluation. Specifically, paragraph 10 of ISA 620 requires the auditor to obtain a sufficient understanding of the specialist's field of expertise to enable the auditor to determine the scope and objectives of the specialist's work, and evaluate the adequacy of specialist's work.

Further, as engaged specialists are not subject to the audit firm's system of quality control, we believe there are opportunities for the auditor to expand his or her evaluation of the knowledge and skill of the engaged specialist. For instance, ISA 620, in particular paragraph 9 and the related application guidance in paragraphs A15 through A17 provides guidance, including potential sources of information the auditor could obtain and other matters that the auditor could consider, in evaluating the engaged specialist's knowledge and skill. Therefore, we encourage the Board to consider similar guidance in advancing the auditor's responsibilities in this area.

Informing the Specialist of His or Her Responsibilities

We support the Staff's potential requirement for the auditor to reach an agreement with the auditor's specialist, in writing, on certain matters that are the responsibility of the specialist.¹² However, we believe flexibility in the approach to matters covered and methods of evidencing the agreement will foster more effective two-way communication between the auditor and the auditor's specialist, and the auditor should be allowed to comply with these requirements in various forms (e.g., engagement letter, as part of planning procedures, audit programs, separate memorandum, or other documentation). In particular, footnote 74 of the Consultation Paper provides the auditor with flexibility in evidencing such agreements and we believe similar language should be explicitly stated within the enhanced auditing standards.

¹⁰ Page 36, the Consultation Paper.

¹¹ Consistent with the general application guidance within International Standard on Auditing 220, Quality Control for an Audit of Financial Statements and paragraph A13 of ISA 620.

¹² Page 37, the Consultation Paper.

Evaluating the Work of the Auditor's Specialist

We appreciate the Staff's efforts in considering the need for specific requirements for evaluating the work of an auditor's specialist (whether employed or engaged), to ensure alignment with the requirements of paragraph 5(c) of AS 10.¹³ However, requiring the auditor, in instances where the specialist develops independent estimates, to "*determine whether*"¹⁴ the methods (and possibly models) used by the specialist are appropriate, and the significant assumptions used by the specialist are reasonable, could result in the auditor re-performing the specialist's work and developing an independent conclusion on the audit matter, notwithstanding that this may be the very reason the auditor engaged the specialist. Further, if the auditor has concluded that a specialist is competent, objective, and has an understanding of the specialist's responsibilities, it is unclear to us why the auditor should not be able to rely on the specialist's execution of the procedures and evaluate the reasonableness of the specialist's conclusions. Additionally, requiring the auditor to validate the specialist's conclusions (i.e., re-perform the specialist's work) could impose a mandate that the auditor must have the expertise of a person trained for or qualified to engage in the practice of another profession or occupation. This goes against the core premise of AU 336, in which the auditor is not expected to possess the expertise of another profession.

We continue to believe it is necessary for the auditor to evaluate the significant methods and assumptions used by, and findings or conclusions reached by the specialist, taking into account the relevance and reasonableness of the findings and conclusions and their consistency with other audit evidence, regardless of whether the specialist develops an independent estimate or tests the methods and assumptions used by management. However, the auditor should not be required to re-perform the specialist's work or validate a specialist's models. Further, consistent with ISA 620, in situations where the auditor believes that the findings of the specialist are inconsistent with other audit evidence, the auditor should agree with the specialist on the nature and extent of further work to be performed by the auditor's specialist or perform additional audit procedures appropriate to the circumstances.¹⁵

Evaluating Objectivity

Evaluating the objectivity of an auditor's specialist (whether employed or engaged) is important in determining the reliability of the work provided by the specialist as audit evidence. We support the Board's intention to enhance the auditor's responsibilities to evaluate the objectivity of an auditor's specialist. However, there are certain suggestions in the Consultation Paper that we believe could significantly affect the auditor's ability to engage specialists, and we do not support any suggested amendments to the auditing standards that would result in significant additional efforts (and costs), or create barriers for smaller to medium-size audit firms to continue to audit public companies. We also do not support any amendments that could potentially diminish the population of engaged specialists, who may decide to forego working with audit firms due to extensive compliance and monitoring requirements.

A specialist's objectivity is a factor that significantly affects whether the work of the specialist will be adequate for the auditor's purpose, and the auditor should assess matters that would be relevant to the specialist's objectivity. Below we have provided our views and recommendations regarding the alternative

¹³ Page 39, the Consultation Paper.

¹⁴ Page 40, the Consultation Paper.

¹⁵ Paragraph 13, ISA 620.

approaches considered by the Staff in potentially enhancing the auditor's evaluation of the objectivity of an engaged specialist.

- Compliance with Rule 2-01 of Regulation S-X

We do not support the Staff's potential alternative of requiring the auditor's engaged specialist to comply with the provisions of Rule 2-01. As noted earlier, an engaged specialist is not considered a member of the engagement team, and therefore, would not be subject to the audit firm's system of quality control, including the audit firm's compliance with (and monitoring of) the Securities and Exchange Commission's independence rules. As Rule 2-01 was written primarily for accounting firms (i.e., audit firms), it is unlikely that specialists not associated with an audit firm would have adopted policies and systems of quality controls to assess compliance with the rule. Accordingly, for a specialist to comply with (or provide reasonable assurance to the audit firm that the engaged specialist has complied with) Rule 2-01, the specialist would have to adopt new policies, procedures, and controls, some of which the specialists may not be able to adopt without undue burden and significant costs.

It is also unclear from the Consultation Paper who would ultimately be responsible for evaluating the specialist's compliance with Rule 2-01, as many specialists may not have quality control systems designed to ensure compliance with independence requirements. This could potentially result in audit firms being required to evaluate and monitor compliance with regulations of individuals and entities outside the auditing profession, of which we adamantly oppose. Audit firms that do not employ specialists may also not find it cost-beneficial to establish an infrastructure to evaluate and monitor engaged specialist's compliance with Rule 2-01, which could limit audit firms' ability to continue to audit certain public companies, particularly for smaller and medium-size audit firms. Further, some specialists could decide not to accept engagements with audit firms due to the compliance and monitoring requirements of Rule 2-01. This would diminish the population of available specialists and could have a significant impact on the quality of an audit; particularly in situations where there is a limited number of specialists that possess a particular skill.

In essence, Rule 2-01 was written for audit firms and not for other organizations; specialist entities and individual specialists may have considerable challenges in complying with this rule. Requiring engaged specialists to comply with Rule 2-01 likely will also impose significant limitations on an auditor's ability to engage a specialist willing to implement processes and procedures necessary to demonstrate compliance with Rule 2-01. Therefore, we strongly recommend the Board not pursue this alternative.

- Enhanced Objectivity Approach

We generally support the Staff's consideration of an enhanced objectivity approach that would expand upon the current requirements of AU 336, but not impose direct compliance with Rule 2-01 that could limit the auditor's ability to engage a specialist or hinder the specialist's ability (or desire) to provide services to audit firms. In particular, we support the identification of certain business relationships, financial relationships, or employment relationships that could impair a specialist's objectivity, and generally, auditors today perform certain inquiries of engaged specialists in order to assess this. However, it is unclear to why the auditor should be required to "*obtain information about the process used by the auditor's engaged specialist to formulate responses to the auditor's request for information*,"¹⁶ as we do not believe the audit evidence obtained would be of sufficient benefit to the audit to warrant the potential

¹⁶ Page 50, the Consultation Paper.

costs to accumulate such information. We believe a more appropriate approach is for the Staff to consider guidance similar to ISA 620, which requires, in instances where the auditor is evaluating the competence, capabilities, and objectivity of an external expert (i.e., engaged specialist), inquiries regarding interests and relationships that may create a threat to that expert's objectivity.¹⁷

Finally, we do not agree with the Staff's suggestion that if a specialist's objectivity is impaired, the auditor should not use the work of a specialist,¹⁸ as this would remove the ability for the auditor to apply additional procedures and could limit the auditor's ability to use the work of the specialist when certain relationships are noted. For instance, there may be situations where there are very few specialists that possess a particular skill, which could limit the auditor's ability to engage a qualified secondary specialist.

AU 336 provides an appropriate framework¹⁹ for responding to situations in which the auditor believes a relationship with the company might impair the specialist's objectivity. This includes the auditor performing 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 engaging another specialist for that purpose, and we encourage the Staff to consider maintaining and incorporating enhancements to strengthen this framework. For instance, AU 336 could be enhanced to provide additional clarification around the auditor's objectivity evaluation, including how this evaluation affects the auditor's assessment of the reliability of the evidence obtained from the specialist.

Use of a Company's Specialist

In evaluating the alternatives contained within the Consultation Paper, we recognize the need for additional guidance to enhance practice, due to potential varying interpretations of AU 336. However, as previously mentioned, we do not support the Staff suggestions to rescind AU 336, as we believe rescinding AU 336 could limit the auditor's ability to exercise professional judgment in determining the sufficiency of audit evidence based on risk, and inadvertently create a requirement for the auditor to now possess expertise in areas and professions outside of accounting and auditing. Ultimately, this would be costly to both audit firms and issuers, and would not provide a correspondingly significant increase in audit quality.

The auditor's ability under AU 336 to utilize the work of a company's specialist, if it is responsive to the auditor's assessment of risk, should be maintained and strengthened through certain clarifying guidance, and we support enhancements to AU 336 that would allow the auditor to continue to exercise professional judgement in response to assessed audit risks. International Standard on Auditing 500, *Audit Evidence* ("ISA 500") includes specific consideration for information that has been prepared using the work of a company's specialist ("management's expert" in ISA 500) and used as audit evidence. In particular, paragraph 8, and related application guidance (i.e., paragraphs A34 – A48), of ISA 500 notes that the auditor should take into account the competency, capabilities, and objectivity of the specialist, obtain an understanding of the specialist's work, and evaluate the appropriateness of the specialist's work as audit evidence. We believe this guidance provides an appropriate framework for the auditor to apply professional judgment and retain the flexibility in evaluating the risk and responding accordingly.

¹⁷ Paragraphs 9 and A20, ISA 620.

¹⁸ Page 47, the Consultation Paper.

¹⁹ Paragraph 11, AU 336.

Finally, we recognize the need for additional clarity; however, we do not believe it is appropriate to eliminate language in AU 336 that states, “*the appropriateness and reasonableness of the methods and assumptions used and their application are the responsibility of the specialist*”²⁰ as this statement specifically supports the core principle that the auditor is not expected to have the expertise of another profession. Therefore, we encourage the Board to consider retaining and enhancing this extant language. For instance, implementing similar guidance to paragraph 8 of ISA 500 would provide a better path for the auditor to evaluate the specialist and understand the specialist’s work, while maintaining the notion that the methods and assumptions are the responsibility of the specialist.

Testing Specialist Information as it Came from Management

We agree an auditor should evaluate the significant assumptions and inputs used by a company’s specialist similar to evaluating information produced by the company’s management. However, imposing a requirement for the auditor to evaluate the reasonableness of the methods (and models) used by a company’s specialist in the same manner as the auditor evaluates information produced by the company’s management could result in the application of audit procedures that are inconsistent with the assessed risk of material misstatement. Such a requirement would also substantially limit the reliance an auditor could place on the specialist’s work, and the auditor (or the auditor’s engaged or employed specialist) would have to re-perform the work of the company’s specialist, regardless of the auditor’s assessment of risk of material misstatement.

The Staff acknowledges that in cases when the auditor does not possess the specialized knowledge or skill to perform the more rigorous procedures that would result from implementing either suggested alternative noted within the Consultation Paper, the auditor may need to employ or engage their own specialist.²¹ We agree this is appropriate when the auditor’s risk assessment indicates such a response is warranted. However, if required to test all of the company’s specialist information as if it came from management, this could result in the auditor employing or engaging their own specialist in situations where such a response may not be supported or reflective of the auditor’s risk assessment. The auditor’s specialist would essentially be performing similar tasks as the company’s specialist, which could result in duplication of efforts, and create potential audit inefficiencies, without any evidence of a corresponding benefit to financial statement users or consideration of the auditor’s assessed risk to the financial statements.

We believe that the auditing standards should continue to be responsive to the auditor’s assessment of risk of material misstatement, and allow the auditor to design an audit approach responsive to risk. While in some cases using an auditor’s engaged or employed specialist to evaluate the work or conclusions of a company’s specialist is appropriate (when the auditor’s risk assessment indicates such a response is warranted), we caution against considering amendments to the auditing standards that would make this a requirement in all cases.

²⁰ Page 30, the Consultation Paper.

²¹ Ibid.

Definitions

We support the Staff's suggested specialist definitions,²² including the continued recognition of income tax and information technology as specialized areas of accounting and auditing and the exclusion of those persons from the definition of a specialist. We also commend the Staff for acknowledging that the definition of an auditor's specialist should not include all third parties that an auditor might use, particularly, a third party that provides prices of financial instruments to the auditor that it routinely makes available for a fee,²³ and believe this important distinction should be acknowledged in the auditing standards.

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DHG 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. We appreciate the opportunity to comment on the Staff's Consultation Paper and are pleased to discuss any questions the Board and its Staff may have concerning our comments. Please direct any questions to Dave Hinshaw, Managing Partner, Professional Standards Group at 704.367.7095 (dave.hinshaw@dhgllp.com) and Jeffrey Rapaglia, Partner, Professional Standards Group at 704.367.5914 (jeff.rapaglia@dhgllp.com).

Sincerely,

Dixon Hughes Goodman LLP

Dixon Hughes Goodman LLP

²² Page 34, the Consultation Paper.

²³ Ibid.