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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. 044

Deloitte & Touche LLP (“D&T” or “we”) is pleased to respond to the request for comments from the Public Company Accounting Oversight Board (the “PCAOB” or the “Board”) on its *Proposed Amendments to Auditing Standards for Auditor’s Use of the Work of Specialists* (the “Proposed Amendments” or “the Proposal”), which addresses potential changes to the PCAOB’s auditing standards for using the work of specialists. Our comments herein should be read concurrently with our comments provided in response to the request for comment from the PCAOB on the *Proposed Auditing Standard for Auditing Accounting Estimates, Including Fair Value Measurements* (the “Estimates Proposal”), as certain provisions of the proposed auditing standards include references between the two proposals in order to illustrate how the proposed requirements in the two releases would work together.

Overall Comments

We support the Board’s efforts to enhance the standards of the PCAOB relating to the auditor’s use of the work of a specialist. We acknowledge and appreciate the PCAOB staff’s efforts in this area to date, including their commitment to seek further input through the issuance of the Proposal. We commend the PCAOB Staff and Board Members for devoting a significant portion of the June 1, 2017, *Open Board Meeting to Consider Adopting Standard on the Auditor’s Report, and Proposing Updated Requirements for Auditing Accounting Estimates and an Auditor’s Use of the Work of Specialists* to discussing matters relevant to the Proposal.

In addition, we believe that the PCAOB’s efforts in considering amendments to the standards addressing use of the work of a specialist along with the Estimates Proposal is thoughtful and appropriate. These concurrent proposals allow commenters to better evaluate and analyze the effect of such proposed amendments, both individually and collectively, and for the PCAOB to consider the feedback collectively as well. We continue to believe it will be important that any resulting amendments pertaining to these two proposals become effective at the same time. In addition, we recommend the effective date should provide auditors with a period of at least two years from the time the standard is approved by the SEC, as we believe there could be significant efforts for accounting firms and specialists engaged by auditors to undertake in order to properly prepare to implement these requirements.

We agree with the proposed distinctions among the work of a company’s specialist, an auditor’s employed specialist, and an auditor’s engaged specialist and the related organization of the proposed amendments within the separate auditing standards for *Audit Evidence*, *Supervision of the Audit Engagement*, and *Using the Work of an Auditor-Engaged Specialist*. These distinctions and resulting organization within the auditing standards provide the basis for a better understanding by the auditor of the requirements for each type of specialist based on how that specialist is used in the context of the audit and also provides the ability to compare and contrast the requirements for each type of specialist across the standards.

We are very supportive of the design of the proposed amendments to align the applicable requirements with the PCAOB’s risk assessment standards. The application of a risk-based approach to the testing and evaluation of a company’s specialist’s work and the supervision of an auditor’s specialist will reduce the risk of the auditor failing to sufficiently and appropriately address identified risks of material misstatement and will also avoid unnecessary effort by the auditor and the auditor’s specialist.

We offer certain constructive suggestions to help clarify the final standards’ requirements and auditors’ responsibilities that are applicable when using the work of a company’s specialist or involving an auditor’s

specialist. We are ready to engage constructively with the Board and other stakeholders to provide our perspective and experience in order to facilitate the development of improvements to the PCAOB's auditing standards that will enhance audit quality. We present a summary of the following primary matters for additional consideration, with additional information on each in the attached appendix:

- Assessing the Knowledge, Skill, and Ability of a Company's Specialist and the Specialist's Relationship to the Company.
- Testing and Evaluating the Work of a Company's Specialist.
- Evaluating Whether the Data Was Used Appropriately by a Company's Specialist.
- Auditor-Employed Versus Auditor-Engaged Specialists.

Assessing the Knowledge, Skill, and Ability of a Company's Specialist and the Specialist's Relationship to the Company

We acknowledge that a company's specialist's knowledge, skill, and ability affects the relevance and reliability of the specialist's work, and therefore it is appropriate for auditors to assess these characteristics when evaluating and testing the work of the specialist. However, we believe additional clarity is needed for consistent application by auditors regarding certain of the proposed requirements.

Assessing Relationships with Company-Engaged Specialists

Paragraph B4 of Appendix B of proposed AS 1105 describes the auditor's requirements to assess the company's specialist's relationship to the company and the entity that employs the specialist. Although the intent of the requirement is clear, clarification is needed as to what procedures an auditor would be expected to perform to obtain sufficient appropriate audit evidence to address the requirement, including the nature and extent of audit procedures that may be performed to complete the assessment.

We recognize the proposal acknowledges that proposed AS 1105.B4 "does not prescribe specific steps to perform or information sources to use in assessing the specialist's relationship to the company"¹ and instead lists potential sources of relevant information within Appendix 3 of the release accompanying the proposal. We recommend that the proposed standard incorporate the potential sources of relevant information included in Appendix 3 as guidance and provide further clarity regarding what is considered sufficient appropriate audit evidence supporting the auditor's assessment of any relationship between the company and the company's specialist.

For example, it is unclear as to whether inquiry or responses to questionnaires from the company's engaged specialist would provide sufficient evidence to identify and assess relationships between the company and its specialist in meeting this requirement. Generally, inquiry alone is not sufficient audit evidence.

Further, many entities do not have processes and controls in place to identify and monitor relationships with their customers (e.g., entities that employ specialists engaged by companies may not actively monitor their employees' financial interests, including stock holdings or other investments). Accordingly, with these challenges in mind, we believe that additional clarity is necessary regarding the procedures the auditor would be expected to perform to identify the relationships a company's engaged specialist has with the company.

In addition, it is unclear how the auditor would determine whether a relationship between the company and the company's engaged specialist would result in the company having significant influence over the engaged specialist.

For example, if an auditor becomes aware of a relationship (e.g., a financial interest) between a specialist employed by an organization engaged by the company being audited and the company

¹ Page A3-13 of the Proposal.

being audited that could be material to the individual specialist, would that result in a conclusion that the company has significant influence over the organization employing the specialist? Would the individual specialist have to be directly involved in providing services to the company being audited, or would it make a difference if the specialist with the relationship was not personally providing services to the company being audited? If the specialist with the relationship had a significant role in managing the specialist's organization, would that result in the company having significant influence over the specialist's organization, even if such specialist was not directly involved in providing services to the company being audited?

In situations in which circumstances exist that the auditor concludes the company has the ability to significantly influence the specialist's judgment, it is not sufficiently clear how this would affect the auditor's ability to use the work of the company's engaged specialist as audit evidence and what alternative procedures the auditor may perform in these circumstances.

Consideration of Management's Controls

When indicating factors that are relevant to the assessment of the specialist's knowledge, skill, and ability, the proposed amendments do not mention consideration of management's controls related to a company's specialists. We believe that management's controls related to the selection and supervision of a company's specialist are very relevant to the auditor's understanding and assessment of the knowledge, skill, and ability of the company's specialist. Management's controls over inputs to the company's specialist (including information produced by the company) and output from the company's specialist would also influence the relevance and reliability of the evidence produced by the company's specialist. The auditor could also consider the effect of these controls when evaluating the audit procedures required to evaluate and assess the work of the company's specialist. We recommend providing additional guidance within the proposed amended standards to clarify the role of management's controls and how such controls (or the lack thereof) may affect the auditor's procedures.

Testing and Evaluating the Work of a Company's Specialist

Our observations and recommendations support the goal of a risk-based approach that acknowledges the effect certain factors have on the required persuasiveness of the evidence the auditor needs to obtain when testing and evaluating the work of a company's specialist. As it relates to the methods and significant assumptions used by the company's specialist, the proposal elevates the requirements in the extant standards from "obtain an understanding"² of such methods and assumptions to "evaluating the methods and significant assumptions used by the specialist."³ We agree that this is likely to represent a significant change in practice and have provided the following observations and recommendations specific to these changes.

- *Limitations to the auditor's ability to evaluate work of a company's specialist* — There are certain limitations to the nature and extent of the evaluation an auditor may be able to perform on the work of a company's specialist. Auditors may not have the expertise to fully evaluate the methodologies and assumptions used by a company's specialist. Although in certain situations it would be possible for the auditor to involve a specialist to assist in completing this evaluation, even a specialist may not be able to fully evaluate the methodologies and assumptions in situations in which the company's specialist uses proprietary or otherwise confidential models, methodologies, or frameworks. Furthermore, given continued technological advancements, it is increasingly more common for specialists to use proprietary or confidential models, methodologies, or frameworks.

Therefore, we recommend the proposed amendments include considerations as to how an auditor would test and evaluate the work of a company's specialist when the specialist uses proprietary or otherwise confidential models, methodologies, or frameworks.

For example, specialists who complete volumetric surveys for inventories of various

² PCAOB AS 1210.09.

³ Page A1-12 of the Proposal.

materials may use GPS survey techniques and computer modeling to estimate volumes of inventories that are highly dependent on proprietary and confidential models and methodologies. In this example, the auditor, or an auditor's specialist, may be able to obtain an understanding of the methods and significant assumptions as required under our extant standards, but may not be able to evaluate fully the methods and significant assumptions, given their proprietary nature.

Situations such as the above example would affect the auditor's ability to test and evaluate the work of a company's specialist and the information provided by a company's specialist, and further may preclude the auditor from being able to meet the requirements of the proposed amended standard. Examples of what additional procedures should be performed in such a scenario would better inform the auditor as to how to apply the requirements, and provide for more consistent auditor execution.

- *Additional clarity to illustrate varying responsive procedures* — Examples provided in the release accompanying the proposal illustrating various ways in which factors can affect the necessary audit effort in testing and evaluating the work of a company's specialist are helpful; however, they stop short of illustrating how an auditor's procedures would change depending upon the necessary persuasiveness of audit evidence.

Example 1⁴ in the release accompanying the proposal states that the auditor would need to extensively test and evaluate the work of the company's specialist. However, it is unclear what "extensive" testing would entail in this case, relative to what "less extensive" testing might involve. In contrast, Example 3,⁵ highlights "less extensive procedures," especially when assessing whether the data was appropriately used by the specialist (see further comments in the next section of this letter regarding the requirement for the auditor to evaluate whether the data was used appropriately by the specialist), but does not then contrast that with "extensive" procedures. We recommend expanding Examples 1, 2, and 3 in Appendix 3 to provide additional clarity as to how the auditor's procedures would change in each of these examples, thereby demonstrating the differences in the necessary persuasiveness of audit evidence.

Further, Example 1 states that the auditor would likely need to engage an auditor's specialist to evaluate and test the work of a reserve engineer. As it is unlikely that audit firms will have internally employed reserve engineers, they will likely have to engage a third-party specialist. It may be difficult or impossible to engage a specialist who has the necessary knowledge, skill, ability, and objectivity in such situations. We have similar concerns that other industries may also lack internal and external specialists who have the necessary objectivity for an auditor to engage, in order to assist in testing and evaluating the work of a company's specialist. We recommend using Example 1 as one means to demonstrate how the auditor could manage or overcome these limitations.

Evaluating Whether the Data Was Used Appropriately by a Company's Specialist

In addition to our observations and recommendations above related to testing and evaluating the work of the company's specialists, we have further commentary specific to the requirement for the auditor to evaluate whether the data was appropriately used by the specialist.

Paragraph B8 of Appendix B in the proposed amended standard requires the auditor to "(1) test the accuracy and completeness of company-produced data used by the specialist, (2) evaluate the relevance and reliability of data obtained from external sources, and (3) evaluate whether the data was appropriately used by the specialist." Item (3) in this requirement is new in comparison to the extant standards. However, no additional information was provided regarding the procedures an auditor should perform to meet this requirement. We recommend providing additional clarity on procedures an auditor should perform to make this evaluation, especially in situations in which the auditor may not have the full expertise to make such an evaluation in circumstances in which the specialist is in a highly specialized area.

⁴ Page A3-19 of the Proposal.

⁵ Page A3-20 of the Proposal.

In addition, we are not aware of procedures an auditor could perform to determine whether data was “appropriately” used by the specialist, other than reperformance by the auditor of the specialist’s calculations.

For example, developing an independent estimate and comparing it to management’s recorded estimate may not meet the requirement to evaluate whether the data was appropriately used by management’s specialist. Different methods, assumptions, and/or data could be used by the auditor and the resultant independent estimate may approximate the recorded estimate; however, that would not support that management’s specialist used the data appropriately, but rather only support that the recorded amount was reasonable.

If the intent of this amendment is to require reperformance, we recommend clarifying that the auditor is required to reperform the specialist’s calculations to meet the requirement. If this is not the intent, clarification as to what procedures should be performed in order to meet the requirement is needed. If reperformance by the auditor of the specialist’s work is the intent of meeting this requirement, we believe this would require significant effort in excess of what is currently performed under the extant standards. Reperformance would also be affected by, or may not be possible because of, other circumstances, including for example, the use of proprietary or otherwise confidential models, methods, or frameworks by a company specialist (especially a company-engaged specialist). Therefore, without clarification as to the intent of this requirement, it is likely that the procedures applied by auditors to address these requirements will vary. It is possible that some auditors may perform too much work, while others may not perform enough work, resulting in insufficient audit evidence.

Further, given the nature of the work performed by the specialist, it will often be difficult for the auditor to evaluate whether the data was appropriately used by the specialist, especially depending on the nature and extent of procedures required. This could lead to situations in which auditors are required to engage external specialists to assist in performing such procedures, whereas currently the auditors are able to meet the extant requirements of evaluating the company’s specialist work without the assistance of an auditor’s specialist. In areas in which auditors have historically used the work of an auditor’s specialist in evaluating and testing the work of a company’s specialist, the scope of such work would likely also expand under these requirements. The extended use of an auditor’s specialist in such scenarios would likely add cost and time to the audit. This may also present problems in certain industries that have a lack of external specialists available to assist in performing such procedures (e.g., the energy industry), or when such external specialists would not have the necessary objectivity to assist the auditor.

Auditor-Employed Versus Auditor-Engaged Specialists

We fully support separately defining requirements for an auditor-employed and auditor-engaged specialist. Our observations and recommendations are intended to clarify the definition of an auditor-employed specialist such that audit firms are clearly able to differentiate between auditor-employed and auditor-engaged specialists, considering the manner in which accounting firms and their networks are legally organized, and recognizing there are different approaches in place across the industry for global accounting firms.

As currently drafted, the proposed amendments define an auditor-employed specialist as a specialist employed by the auditor’s firm. Depending on the legal organization and affiliations of an accounting and auditing firm, this may result in inconsistent interpretations regarding whether specialists are auditor-engaged or auditor-employed specialists.

For example, if specialists are not legally employed by the accounting and auditing firm, but rather by an affiliate or a subsidiary of the same parent company of the accounting and auditing firm, it could be interpreted that such specialists are auditor-engaged specialists versus auditor-employed specialists, even in circumstances in which quality control structure and independence requirements are the same for the respective legal entities employing the specialists and the auditors.

Additional clarification specific to these proposed amended standards would help accounting and auditing firms avoid applying the proposed standards differently or other than as intended.

We offer further observations on other areas of the Proposal in the attached appendix.

* * *

D&T appreciates the opportunity to provide our perspectives on these important topics. Our comments are intended to assist the PCAOB in analyzing the relevant issues and potential effects of the Proposal. We are ready to collaborate with the PCAOB on these important matters. If you have any questions or would like to discuss these issues further, please contact Dave Sullivan at 714-436-7788 or Megan Zietsman at 203-761-3142.

Very truly yours,

A handwritten signature in cursive script that reads "Deloitte & Touche LLP". The signature is written in black ink on a white background.

Deloitte & Touche LLP

cc: James R. Doty, PCAOB Chairman
Lewis H. Ferguson, PCAOB Member
Jeannette M. Franzel, PCAOB Member
Steven B. Harris, PCAOB Member
Martin F. Baumann, PCAOB Chief Auditor and Director of Professional Standards

Jay Clayton, SEC Chair
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Marc A. Panucci, SEC Deputy Chief Accountant
Sagar S. Teotia, SEC Deputy Chief Accountant
Russell G. Golden, FASB Chairman

APPENDIX

The comments noted in this appendix are intended to provide additional observations and recommendations related to the proposal. These comments are organized by the auditing standards proposed to be amended, along with a general observation at the end of the appendix.

AS 1105, Audit Evidence

- We believe consideration should be given to the nature of the typical relationship between a company and their legal counsel to assess the effect on these proposed amendments. Given the nature of the role of legal counsel engaged or employed by a company, the nature of the relationship between the entities, and the existence of attorney-client privilege and privacy and confidentiality agreements, it is likely that there will be relationships between legal counsel and the company that employs or engages them that would allow the company the ability to significantly affect the specialist's judgment. Additional guidance is necessary for an auditor to understand how they can address these commonplace circumstances in order to apply the auditing standards. In addition, providing greater clarity in the amendments as to how this situation would influence the procedures the auditor performs to assess the knowledge, skill, and ability, and how this influences the relevance and reliability of the specialist's work would be helpful to audit quality. Further, the existence of attorney-client privilege and privacy and confidentiality will influence the auditor's ability to evaluate the work of legal counsel.

For example, if a company obtained a legal opinion from counsel regarding an income tax matter, counsel may not be willing to provide the data or information used and considered in reaching such opinion. Limitations such as these may not be able to be overcome by the auditor.

Therefore, we recommend including additional guidance to inform auditors how to address these circumstances. Lastly, there are also long-standing arrangements and agreements for auditors' interactions with legal counsel, and it is not clear how the proposed amendments are intending to change such arrangements and agreements. The American Bar Association was active in prescribing how legal counsel should respond to an auditor inquiry, so it is likely they may wish to provide further input as this standard approaches finalization.

- Paragraph B10 requires the auditor to perform additional procedures if the auditor determines the specialist's findings or conclusions appear to contradict the relevant assertion or the specialist's work does not provide sufficient appropriate evidence in accordance with paragraph B9. We recommend providing additional clarity by specifying the procedures auditors would need to perform in responding to the requirement of paragraph B10. In addition, the note to paragraph B10 includes examples of situations in which additional procedures ordinarily are necessary. Item (5) of the note to paragraph B10 states that "the specialist has a conflict of interest relevant to the specialist's work." Clarification as to what this example would relate to would be helpful.

AS 1201, Supervision of the Audit Engagement, Appendix C

- Paragraph C5 of Appendix C refers to requirements to establish and document an understanding related to "the nature of the work that the specialist is to perform" and "the specialist's approach to that work." Additional clarification regarding what is meant by the specialist's "approach" would assist the auditor in understanding how "approach" is different from the "nature of the work" and what the auditor needs to understand and document related to this piece of the requirement.
- Paragraph C7 of Appendix C uses a new term, "measures," when describing that the engagement partner and, as applicable, other engagement team members performing

supervisory activities should implement “measures to determine that there is a proper coordination of the work of the specialist with the work of other relevant engagement team members.” This terminology is not used in other PCAOB standards, including AS 1201. Examples of what these “measures” to be implemented would be would provide clarity to the auditor as to what is expected of them in meeting this requirement.

- In the note to paragraph C9 of Appendix C, the term “reasonable basis” is used to describe an example of when additional procedures ordinarily are necessary (i.e., when the specialist lacks a reasonable basis for data or significant assumptions). This term is not defined in the proposal, although it is used in AS 1105. However, in that context, it is used in relation to the sufficiency and appropriateness of the audit evidence necessary to support the auditor’s opinion and therefore supported by the context of the additional guidance in AS 1105 about how to make that evaluation and underpinned by the overall concept of the auditor obtaining reasonable assurance. It does not appear that the term, as used in the note to paragraph C9, can have the same meaning, and it’s not, therefore, clear how the auditor would make the determination as to whether a specialist lacks (or has) a reasonable basis for data or significant assumptions.

AS 1210, Using the Work of an Auditor-Engaged Specialist

- Paragraph 04 of the proposed amended standard includes a requirement to “assess whether the specialist and the entity that employs the specialist has the necessary objectivity to exercise impartial judgment on all issues encompassed by the specialist’s work related to the audit.” It is unclear what extent of procedures are necessary for an auditor to perform to evaluate objectivity. In addition, it will be difficult for an auditor to predict all issues encompassed by the specialist’s work in making this objectivity evaluation as required in paragraph 04.

The requirement also includes evaluating whether the auditor-engaged specialist or the entity that employs the auditor-engaged specialist has a relationship to the company or any other conflicts of interest relevant to the work to be performed. Similar to our concerns regarding this requirement for a company-engaged specialist included in our letter above, additional clarity is needed on the extent of procedures to evaluate this relationship requirement. As currently written, we believe this requirement will result in different interpretations that will lead to inconsistencies in practice. Examples of how different situations involving different relationships may influence the auditor’s ability to evaluate objectivity would be helpful in assisting the auditor in meeting these requirements.

- In situations in which an auditor-engaged specialist is found to lack the “necessary objectivity to exercise impartial judgment,”⁶ the proposed amended standard appears to preclude auditors from using the work of the specialist. Clarification or examples to assist with understanding the “threshold” of when a circumstance may cross into having a lack of “necessary objectivity to exercise impartial judgment” are needed, as leaving that “threshold” open to interpretation may lead to inconsistencies in applying the requirements.
- Since auditor-employed and auditor-engaged specialists are supervised and reviewed by the auditors in a similar manner in the proposed amended standards, we recommend including a reference to address how disputes or disagreements between the auditors and specialists should be resolved.

Additional Comment on the Proposal

- Elimination of the distinction between being “in the field of accounting and auditing” or “outside the field of accounting and auditing” as it pertains to the auditor’s specialist and clarification on how the difference pertains to the company’s specialist would provide clarity

⁶ Page A1-21 of the Proposal.

to the standards and also align with the nature of work performed by these specialists, particularly as it is becoming harder to draw a distinction between when a specialist may be inside or outside the field of accounting and auditing. For example, as accounting standards move towards fair value accounting, there could be arguments supporting that a specialist in the area of fair value may be no different than a specialist in the area of income taxes.