

## Heads Up

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# A Summary of the June 18 Meeting of the PCAOB's Standing Advisory Group

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### Introduction

At the June 18, 2015, PCAOB Standing Advisory Group (SAG) meeting, the PCAOB provided an update on recent developments, including an overview of its current and future standard-setting activities. In addition, the PCAOB and SAG discussed:

- The use of the work of specialists, including how the company and auditor oversee and use the work of the specialists; how the specialists perform their work; how the auditor evaluates the knowledge, skill, and objectivity of company specialists and engaged specialists and uses their findings; and potential changes and alternatives to address the different requirements in standards that apply to an auditor's employed specialists, an auditor's engaged specialists, and a company's specialists.
- The status of the PCAOB staff's project on auditing accounting estimates and fair value measurements.

### Recent PCAOB Developments

Chairman James Doty summarized the following recent PCAOB activities:

- *Enhancing transparency* — The PCAOB is preparing to seek comments on the disclosure of names of engagement partner(s) and information about other participants in the audit in a new form that registered accounting firms would be required to file with the PCAOB.
- *Audit quality indicators* — The PCAOB continues to model and test potential audit quality indicators in preparation for an upcoming concept release.

**Editor's Note:** The PCAOB held an open meeting on June 30, 2015, to approve a supplemental request for comment on enhancing transparency and a concept release on audit quality indicators. See Deloitte's upcoming [Heads Up](#) for more information.

- *Standard setting* — The PCAOB is exploring ways to improve the efficiency of its standard-setting process. It is working closely with the SEC to evaluate its current process and recognizes the need to quickly consider and adopt potential process changes.
- *Broker-dealers* — Oversight of broker-dealer audits continues to evolve. The PCAOB has just completed its first cycle of broker-dealer inspections, and in January 2015 it issued a special inspection report covering five inspections performed under the PCAOB standards.

- *Inspections and enforcement* — The PCAOB staff is well into its 2015 domestic inspection cycle. It also has more than 50 international inspections planned as it continues to build and strengthen relationships with non U.S. regulators. Many of the international inspections will be conducted in cooperation with the respective foreign regulator. In addition, enforcement remains active, with 24 domestic disciplinary proceedings settled in 2014 and more resources being devoted to international enforcement activity.
- *Center for Economic Analysis* — The PCAOB continues to staff its Center for Economic Analysis, which is a critical component of its standard-setting and inspection processes. The PCAOB is also developing a post-implementation review program to evaluate the effectiveness of new auditing standards.
- *Outreach to audit committees and small firms:*
  - The PCAOB continues to reach out to audit committees and their members regarding the PCAOB's work. In May, the PCAOB released [Audit Committee Dialogue](#), which highlights key recurring areas of concern from PCAOB inspections and emerging risks that the PCAOB is monitoring. It also provides questions that audit committees may consider asking auditors. Feedback from audit committee members indicates that the publication's insights have been useful, and the PCAOB plans to follow up with additional events to continue the dialogue with audit committees.
  - The PCAOB plans to host six forums on auditing small businesses, and four forums on new rules and standards for auditing broker-dealers.<sup>1</sup>

## Standard-Setting Agenda

Chief Auditor and Director of Professional Standards Martin Baumann provided an update on the PCAOB's standard-setting activities outlined in the following table:

Project/Standard	Action Expected by September 2015 <sup>2</sup>
Using the work of specialists	Comments due by July 31, 2015, on staff consultation paper <i>The Auditor's Use of the Work of Specialists</i> (issued May 28, 2015). See <a href="#">Using the Work of Specialists</a> below for highlights of the discussion on this topic.
Auditing accounting estimates and fair value measurements	See <a href="#">Auditing Accounting Estimates and Fair Value Measurements</a> below for an update on the project. (Comment period on the August 2014 staff consultation paper closed in November 2014.)
Auditor's reporting model	Reproposal. <sup>3</sup>
Improving transparency through disclosure of engagement partner and certain other participants in audits	Supplemental request for public comment issued June 30, 2015. Comments are due to the PCAOB by August 31, 2015.
Going concern	Planned staff consultation paper to obtain input on possible changes to PCAOB AU Section 341, <i>The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern</i> , in light of FASB Accounting Standards Update No. 2014-15, <i>Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern</i> .
Supervision of other auditors and multi-location audit engagements	Proposal, which will consist of one standard (rather than the current approach, under which both PCAOB Auditing Standard No. 10, <i>Supervision of the Audit Engagement</i> ("AS 10"), and AU Section 543, <i>Part of Audit Performed by Other Independent Auditors</i> , apply).
Other Active Projects (No Timetable)	Project Direction
Quality control standards, including assignment and documentation of firm supervisory responsibilities	Staff consultation paper.
Confirmation	Reproposal.

<sup>1</sup> The forums are intended to give small-business and broker-dealer auditors an opportunity to learn more about the inspection process and the implications of new auditing standards.

<sup>2</sup> This timeline may change on the basis of future updates to the PCAOB's standard-setting agenda.

<sup>3</sup> Mr. Baumann indicated that the aspects of this project related to the auditor's responsibilities for other information outside the financial statements are not likely to be repropose at the same time as other changes to the auditor's report.

## Using the Work of Specialists

Deputy Chief Auditor Greg Scates provided background on the [staff consultation paper](#) on the auditor's use of specialists and introduced two discussion panels. The first panel focused on perspectives of companies that use the work of specialists; the second focused on perspectives of the auditor and specialists employed or engaged by auditors.

The PCAOB sought feedback from the SAG regarding the different requirements under current standards related to a company's specialists, an auditor's employed specialists, and an auditor's engaged specialists as well as the potential need for improvements to those standards. The PCAOB's staff consultation paper explains some of the current concerns with respect to PCAOB standards and the use of specialists, including the following:

- PCAOB standards have not been updated to reflect changes in how specialists are being used in an audit and may not be sufficiently aligned with the PCAOB's risk assessment standards.
- PCAOB standards, including independence requirements, related to the use of an auditor's employed specialists are different from those that apply to an auditor's engaged specialists.
- PCAOB standards related to supervision of an audit engagement do not provide specific requirements for how to supervise the work of an auditor's employed specialists.
- Under current PCAOB standards, the auditor may use the work of company specialists after performing certain procedures that are not as rigorous as the procedures required to be performed when the auditor receives information from others in the company.

Potential changes to requirements were discussed, including the following:

- *Company's specialists* — Two alternatives were presented to address the treatment of a company's specialists under PCAOB AU Section 336, *Using the Work of a Specialist* ("AU 336"):
  - *Alternative 1* — Amend the requirements of AU 336 to remove provisions that may be considered to limit the auditor's responsibilities to evaluate the work of the company's specialists and thereby require a more robust evaluation by the auditor of the specialists' work (as well as certain other improvements).
  - *Alternative 2* — Rescind AU 336 completely, and require the auditor to evaluate information produced or provided by a company's specialists in a manner similar to evaluating all other evidence provided by management of the company.
- *Auditor's specialists*:
  - Develop a separate standard on using the work of an auditor's specialists that would apply to engaged and employed specialists.
  - Extend the supervision requirements in AS 10 to engaged specialists.
  - Enhance the requirements for an auditor's use of the work of specialists (employed and engaged) related to informing the specialists of their responsibilities and evaluating their knowledge, skill, and objectivity as well as their work and conclusions.
  - Strengthen the requirements related to the auditor's engaged specialists' independence and objectivity.

## Panel Discussion on a Company's Specialists

The panel<sup>4</sup> provided insight on a company's use of the work of specialists, including how specialists perform the work for the company and how the auditor uses the specialists' work. Panelists shared their perspectives, which included describing the experience of a large company that routinely uses specialist services as well as organizations that provide such services to companies of various sizes (e.g., valuation of pension benefit obligations, financial instruments, and stock options). Panelists highlighted the type

<sup>4</sup> The panel consisted of Loretta V. Cangialosi, Pfizer, Inc.; Jouky Chang, Duff & Phelps; Ken Lining, Aon Hewitt; and Wendy B. Stevens, WeiserMazars LLP.

of work that specialists typically perform; the relationship between the company and the specialists; the requisite knowledge, skill, and experience of specialists; quality control; how conclusions and findings are communicated to the company; and how the company responds to the reports provided by the specialists. In addition, it was pointed out that some, but not all, specialists have various certifications and industry-specific regulations and requirements.

Panelists and SAG members also indicated that management's interaction and involvement with a company's specialists varies greatly and that companies may have different processes for using and evaluating the work of specialists (e.g., there may be differences in the extent to which companies evaluate or challenge the methods used by a specialist).

The discussion focused on two alternatives to the requirements in AU 336 related to a company's specialists, both of which would entail the use of more rigorous audit procedures and would require the auditor to more robustly evaluate the specialists' knowledge, skill, and objectivity. Supporters of amending AU 336 generally agreed that while enhancements to the existing standard are necessary, the fundamental concept that auditors are not specialists should be retained. Specifically, SAG members believed that after appropriately evaluating a specialist's knowledge, skill, and objectivity, the auditor should be able to rely on the specialist's expertise. SAG members also expressed the concern that requiring auditors to reperform the work of company specialists may result in a need for the audit firm to acquire additional expertise in areas outside of accounting or engage additional external specialists and that these resources may be both limited and costly. In addition, several constituents believed that auditors do not need to replicate the work of the company's specialists (i.e., recalculate) but rather understand their methods, model, and assumptions as well as the relevance and reliability thereof.

There was strong advocacy for aligning the requirements for the auditor's evaluation and use of the company's specialists' work with the approach taken by the International Auditing and Assurance Standards Board and the AICPA's Auditing Standards Board in the overhaul of their standards by including the requirements in PCAOB Auditing Standard No. 15, *Audit Evidence*.

**Editor's Note:** As part of the clarification of both International Standards on Auditing and the AICPA's auditing standards, the auditor's consideration of a company's specialists was separated from the requirements related to an auditor's specialists and included in each body's respective audit evidence standard (which discusses the requirements that apply when the auditor uses the work of the company's specialist and information produced by the company).<sup>5</sup>

Supporters of rescinding AU 336 cited the need for auditors to treat the work prepared by a company's specialist in a manner similar to their treatment of information provided by management of the company. However, they noted that the additional costs and efforts to implement such an approach were likely to be significant. Further, the SAG cautioned that regardless of the approach, it would be difficult to develop a "one size fits all" approach in the PCAOB standards because of the diversity of specialists involved in assisting companies and auditors.

<sup>5</sup> The IAASB's ISA 620, *Using the Work of an Auditor's Expert*, contains requirements and guidance on using an auditor's specialists. ISA 500, *Audit Evidence*, contains requirements and guidance on using a company's specialists. The AICPA's analogous standards are AU-C 620, *Using the Work of an Auditor's Specialist*, and AU-C 500, *Audit Evidence*.

## Panel Discussion on the Auditor's Specialists

The panel<sup>6</sup> provided background on how auditors oversee, use, and evaluate the work of employed or engaged specialists. Perspectives discussed by the panelists included those of engaged specialists (e.g., from the valuation and engineering professions), large-firm specialists (who are typically employed), large-firm auditors, and a member of academia. AS 10 applies to specialists employed by the auditor (i.e., as such specialists form part of the audit engagement team) while AU 336 applies to specialists engaged by the auditor. The discussion focused on the following alternatives related to the oversight and supervision of such specialists:

- *Alternative 1* — Develop a separate standard for using the work of an auditor's specialists that would apply to engaged and employed specialists.
- *Alternative 2* — Extend the supervision requirements in AS 10 to the auditor's engaged specialists.

The discussion also addressed the different requirements for independence and objectivity that apply when an auditor uses the work of a specialist. Under AU 336, a specialist engaged by the auditor does not need to be independent; however, the auditor evaluates the objectivity of the engaged specialist. The PCAOB sought feedback from the SAG on the following alternatives related to the independence and objectivity of such specialists:

- *Alternative 1* — Apply the independence requirements in SEC Regulation S-X, Rule 2-01, "Qualifications of Accountants."
- *Alternative 2* — Apply an enhanced objectivity approach.

SAG members discussed their concerns about uncertainty related to who "owns" the work provided by engaged specialists and who has ultimate responsibility for the reports and work papers prepared by them. SAG members also debated whether auditors should "get behind" the models used by engaged specialists. Some supported the view that auditors need to own the work of the engaged specialists, while others contended that auditors are often unable to do so because of proprietary information or the auditor's inability to understand what is in the "black box" or model. In addition, the auditor may lack the requisite expertise (e.g., valuation of precious metals) to provide supervision. Further, panelists and SAG members noted that while auditors can test inputs and review methods, there needs to be some level of reliance on specialists and their expertise given that their expertise is the reason they were engaged in the first place.

In discussing current practice, panelists and SAG members indicated that there are generally no formal means to track an engaged specialist's independence. Extending objectivity and independence requirements to engaged specialists, however, may be viewed as a deterrent to a specialist's ability to provide work to auditors since demonstrating that the specialist meets the independence requirements (e.g., implementing systems to track financial interests and personal relationships and monitor compliance) could take a significant amount of time and effort.

## Auditing Accounting Estimates and Fair Value Measurements

Associate Chief Auditor Barbara Vanich provided an update on the Board's project on auditing accounting estimates and fair value measurements<sup>7</sup> and gave SAG members the opportunity to discuss alternatives and provide feedback.

<sup>6</sup> The panel consisted of Andreas Ohl, PricewaterhouseCoopers LLP; Susan DuRoss, Harvest Investments Ltd; Daniel R. Olds, Ryder Scott Company LP; David A. Kane, Ernst & Young LLP; and J. Efrim Boritz, University of Waterloo.

<sup>7</sup> See Deloitte's December 5, 2014, [Heads Up](#) for more information on this project.

Since the August 2014 issuance of its [consultation paper](#) on auditing accounting estimates and fair value measurements, the PCAOB staff has discussed this project at SAG meetings as well as received and analyzed 40 comment letters. On the basis of outreach and commenter input, the staff has identified three key areas in which further research is required:

- *Significant measurement uncertainty* — The PCAOB staff is considering alternatives to more specifically address measurement uncertainty, including:
  - Amending Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement* (“AS 12”), to include factors that may be relevant in the evaluation of the extent of measurement uncertainty in accounting estimates.
  - Adding a requirement to evaluate how management considered alternative assumptions or outcomes for significant risks.
  - Adding requirements to test a model when the complexity of the model used to develop an estimate gives rise to a significant risk.
  - Requiring sensitivity analysis when there is a range of reasonable outcomes.
  - Adding specific disclosure requirements.
- *Emphasizing professional skepticism* — The PCAOB staff is exploring ways to further emphasize professional skepticism in the new standard, including:
  - Adding an explicit requirement for the auditor to identify, when testing management’s process, which of the assumptions used by management are significant.
  - Revising terminology related to “corroborating” management’s estimate to be more akin to “evaluating” management’s estimate.
  - Incorporating reminders in the standard for the auditor to exercise professional skepticism.
  - Emphasizing the auditor’s existing responsibility to consider all relevant audit evidence, both corroborating and contradicting.
  - Extending AS 12 fraud discussion requirements to specifically include estimates.
  - Changing the current order of substantive approaches to begin with evaluating subsequent events (i.e., (1) evaluate subsequent events, (2) develop an independent estimate, (3) test management’s process), thereby emphasizing the option to evaluate subsequent events without changing the requirements.
- *Use of third parties* — The PCAOB staff is exploring alternatives that could apply to management’s use of specialists, including:
  - Addressing the use of third parties in its project on the auditor’s use of the work of specialists (as described above).
  - Largely retaining the approach described in the staff consultation paper (i.e., requiring the auditor to test information provided by a company’s specialist as if it were produced by the company).
  - Retaining an approach similar to that in the staff consultation paper but with some limitations, such as only testing certain assumptions, or testing only when a significant risk is identified in the audit area in which the specialist is involved.
  - Addressing management’s and the auditor’s use of a pricing service and modifying the requirements thereof.

The PCAOB staff believes that one standard on auditing accounting estimates and fair value is the preferable approach since such a standard could provide a more comprehensive approach to auditing accounting estimates and fair value, which by their nature are interrelated, promote greater consistency in practice, and align with the risk assessment standards. SAG members generally supported the

Board's efforts to explore the alternatives outlined as well as to develop one standard on management estimates and fair value. However, commenters expressed mixed views on several issues and questions posed by the staff for discussion. Themes of the comments included the following:

- General support for further integrating the potential standard with the risk assessment standards (e.g., providing guidance on assessing risk for certain types of estimates).
- General support for retaining the three approaches for auditing management estimates: (1) testing management's process, (2) developing an independent estimate, and (3) reviewing subsequent events or transactions; however, the order of emphasis should be considered, and subsequent events should potentially be at the forefront of the auditor's evaluation. Some commenters cautioned against overreliance on subsequent events since that information may only be relevant in certain circumstances. In addition, a valuation is based on information that is known as of the date of the valuation; auditors take this information into account as part of exercising professional judgment.
- Caution against adding too many requirements to the standard, which could potentially result in removing the auditor's ability to exercise professional judgment.
- Consideration of what is adequate for an auditor to address related to measurement uncertainty since auditors cannot eliminate measurement uncertainty entirely through their procedures.
- General recognition that pricing services are not the same as specialists and that the definition of a specialist may need to reflect this distinction. Also, there may be a benefit to allowing auditors to group securities with similar characteristics and risks when performing their testing.

### Next Steps and Request for Public Comment

Comments on the staff consultation paper *The Auditor's Use of the Work of Specialists* should be submitted to the PCAOB staff no later than July 31, 2015. The paper contains a number of questions intended to help the staff understand various perspectives on existing standards and alternatives. Comments to the PCAOB should be sent to the Office of the Secretary, PCAOB, 1666 K Street, N.W., Washington, D.C. 20006-2803. Comments also may be submitted by e-mail to [comments@pcaobus.org](mailto:comments@pcaobus.org) or through the PCAOB's Web site at [www.pcaobus.org](http://www.pcaobus.org).

With respect to the PCAOB's project on auditing accounting estimates and fair value measurements, the staff is expected to recommend that the Board propose a standard for public comment in the fourth quarter of 2015.

The next PCAOB SAG meeting is scheduled for November 12–13, 2015.

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