July 31, 2015

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street NW
Washington DC 20006-2803
Submitted via email to comments@pcaobus.org

RE: Staff Consultation Paper 2015-01, The Auditor's Use of the Work of Specialists

To Whom It May Concern:

On behalf of the American Academy of Actuaries\(^1\) financial reporting committees,\(^2\) we appreciate the opportunity to provide comments on the Public Company Accounting Oversight Board’s (PCAOB) Staff Consultation Paper 2015-01, The Auditor's Use of the Work of Specialists, dated May 28, 2015. We agree that the issues raised by the PCAOB are important and should be considered, and that the approach to the use of specialists in an audit can be a key factor in the quality of many audits.

In determining the degree of oversight that needs to be applied to the work of a specialist providing assistance on an audit, several key factors should be considered. These include:

- Whether the specialist is an accredited member of a recognized professional body (and is publically identified as such) and the training necessary to receive credentials from that body.
- The extent to which that body has a code of professional conduct, professional standards of both practice and qualification to perform the specialist’s services, and an active disciplinary process.
- The degree to which the body requires continuing professional education and makes public whether those specialists have completed that training.

Our comments on the consultation paper reflect the perspectives of members of the relevant U.S. actuarial organizations who comply with the actuarial Code of Professional Conduct,\(^3\) the

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1 The American Academy of Actuaries is an 18,500+ member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.
3 Code of Professional Conduct, American Academy of Actuaries, 2001, http://actuary.org/files/code_of_conduct_8_1.pdf. This code has been adopted by each of the U.S. actuarial organizations: the American Academy of Actuaries, Society of Actuaries, the
actuarial standards of practice (ASOPs), and the “Qualification Standards for Actuaries Issuing Statements of Actuarial Opinion in the United States” (USQS).

The comments in this letter were prepared by a diverse, cross-practice group of actuaries, all of whom have experience with financial audits encompassing each of the four areas outlined in the paper. Following the response summary, the letter includes our formal responses to the specific questions raised in the consultation paper that are relevant to our work.

**Response Summary**

*Existing Guidance*

In recent years, actuarial practitioners, primarily those directly employed or engaged by audit firms, have noted a significant increase in the depth and intensity of the review of their actuarial work products by core audit teams. We believe that the concerns the PCAOB has regarding existing guidance may be more related to a lack of compliance of some, but not all, specialists with the guidance. We do not believe there are any specific problems with the guidance as it relates to actuarial services or actuarial specialists, as defined by the PCAOB consultation draft.

*One-Size-Fits-All*

One-size-fits-all detailed requirements for specialists are unlikely to be effective or implementable. Even within the actuarial profession, the approaches taken by pension, life insurance, or casualty actuaries may vary and impact the type of validation performed by auditors (e.g., re-performance and assumption review and methodology assessment). Audit procedures that are appropriate for one actuarial practice area may be inappropriate for another.

*Compliance With Accounting Rules*

We believe requiring specialist firms external from the auditors to comply with the accounting profession’s independence rules is impractical. Accounting firms involved in financial audits (audit firms) expend considerable resources to be confident in their ability to assert independence. Many external specialist firms derive a small portion of their revenue from audit-related activities. Imposing additional independence requirements on external specialist firms could result in the external specialists’ deciding it is no longer economically feasible to provide audit specialist services. The requirements could limit competition and, as a result, some audit firms could no longer obtain external specialist assistance. In the case of the U.S. actuarial profession, specialists would remain bound, due to their code of conduct and professional standards, to maintain objectivity in all of their work and disclose any conflict of interest.6

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4 American Society of Pension Professionals and Actuaries, the Casualty Actuarial Society, and the Conference of Consulting Actuaries. Actuaries who are members of these organizations must follow the code.
6 Precept 7 of the Code of Professional Conduct.
Specialists who are employed by audit firms already have to comply with these rules in order to participate as members of an audit engagement team.

Supervisory Authority

A similar issue relates to whether an audit firm is able to extend supervisory authority over an employee of another firm or that employee’s work product. Relinquishing control of one’s employees to an audit firm, while retaining the legal risk associated with those employees, could result in some specialist firms refusing to provide audit assistance. This issue could be mitigated if the employer includes a requirement in the engagement letter that the contracted specialist may provide the audit firm with copies of work papers and access to the preparers as appropriate.

Communication

We agree with the PCAOB’s contention that thorough communication between the audit firm and its internal and external specialists is necessary. This communication could include a detailed and documented understanding of the responsibilities of each party in the audit planning process, the context in which the specialist’s work will be used, and ensuring that those specialists are familiar with the relevant principles of auditing (e.g., professional skepticism). In our experience, the large and mid-size audit firms consistently communicate these items and take steps to communicate with their specialists and prepare thorough audit programs. These firms have detailed procedures to accomplish this communication with respect to internal and external specialists.

Testing Approach

For actuarially determined accounting estimates, the testing approach for estimates through complete re-performance is not practical and does not consider the reasonability of the underlying assumptions within the models. Current guidance as quoted on page 40 of the PCAOB consultation paper describes development of an independent estimate and the testing of

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methods and significant assumptions as two approaches that provide for tailoring the approach to the particular circumstance. PCAOB’s Interim Standard (AU) Section 336, *Using the Work of a Specialist,* further describes the acceptability of the use of an audit approach specific to the particular circumstance that may not involve re-performance or independent testing.

The ability of audit firms to test the work of a reporting entity’s internal or external actuarial specialist varies, depending on what is being tested. For example, an audit firm can test the calculation of a reserve for a specific life insurance policy. Testing of total reserves—the combination of individual claim reserves and incurred but not reported (IBNR) reserves—for a group of casualty or health insurance policies is also reasonable. However, replicating calculations for an estimate based on a complex model that simultaneously handles many different contingencies and outcomes, such as a model used to develop the valuation for an entire pension plan, a large book of life insurance policies, or asbestos obligations of a casualty insurer is a difficult, time-consuming, and costly proposition when less expensive and more efficient methods of obtaining sufficient evidence are available.

Currently, an auditor’s actuarial specialist often can obtain sufficient information to prepare an estimate within the materiality requirement of an audit that will provide the auditor with additional evidence to determine whether the actuarial estimate is reasonable. This alternative test often requires the auditor’s actuary to examine not just the mechanics of the model that is being tested, but also the reasonability of the assumptions made by the reporting entity’s specialist. The reasonability of the assumptions are as important, if not more important, than the mechanical calculations of the reporting entity’s specialist’s model.

In addition, many of these models are proprietary to external firms that have developed the estimate used by the reporting entity. As a proprietary model, the details of the model are owned by the external specialist’s firm and may not be transparent to the user of the results. Preparing a test that is close to re-performance after the reporting entity has completed its work may not be feasible given current reporting time constraints and may cost the reporting entity fees equivalent to or more than what was spent developing the initial estimate.

*Audit Scope Procedures*

We believe a distinction needs to be drawn in audit scope between the procedures necessary when the reporting entity’s specialist involved in determining accounting estimates is employed by the entity and when that specialist is employed by an outside firm. The specialist employed by the reporting entity cannot reasonably be considered to be independent in the audit sense, and objectivity can be difficult to achieve in such a situation. However, objectivity is more likely

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(3) The company’s basis for selecting the methods and assumptions used in developing the estimate, including whether the company considered alternative methods and assumptions...

8 “An audit may use the findings of the company actuaries by (1) obtaining an understanding of the methods and assumptions used by the company actuaries, (2) making appropriate tests of the data provided to the company actuaries and (3) evaluating whether the company actuaries’ findings support the recorded reserves; or perform other test work such as an independent analysis. When reviewing the analysis of company actuaries, the actuary will test certain key assumptions, perform other recalculations or perform spot-checks. If the actuary determines that the findings of the company actuaries support the recorded reserve, further detailed analysis may not be required.”
when the specialist is external, if for no other reason than the external specialist’s employer needing to legally protect itself. In a case in which the reporting entity provides a significant proportion of the revenue of an external specialist, an auditor may need to perform additional procedures to verify the objectivity of the development of the specialist’s work product used. This should not require audit procedures and rules that apply in all cases.

*Revising the Standard of Audit Estimates*

We believe that the revision to this standard should be performed in conjunction with any consequential or associated review of the standard on the audit of estimates, as they are inextricably linked.

*Cooperation*

We believe that the PCAOB and the International Auditing and Assurance Standards Board (IAASB) should cooperate in establishing standards that are as consistent as practical. Such coordination would better enable multinational audit firms or entities to operate and organize the use of specialists in a consistent manner.

*Formal Responses to the Staff Consultation Paper 2015-01 Questions*

1. **Does the information presented in Section III accurately characterize current practice? Are other aspects of current practice – at larger and smaller accounting firms – relevant to the staff’s consideration of potential standard setting in this area?**

   We believe the information presented in Section III accurately characterizes current practice.

2. **Are there any challenges associated with current practice, especially for those accounting firms that have incorporated the standards of the IAASB or of the ASB into their audit methodologies?**

   Challenges to the use of specialists in an audit include: the lack of familiarity of audit staff with actuarial methods; the complex models that are sometimes used by actuaries; and sufficient understanding of the critical data items used by actuaries in their models/methods. Those charged with selecting audit specialists should consider the ability of the specialists to communicate these methods and procedures to non-specialists.

3. **For accounting firms that use the work of an auditor’s specialist:**
   a. **Does the firm employ or engage those specialists? How does the firm decide to employ versus engage a specialist? For larger firms that employ specialists, are there circumstances when the firm uses engaged specialists? If the firm employs and engages specialists, describe the relevant ways in which each may be used in an audit.**

   This decision usually depends on audit economics and the allocation of internal resources (e.g., availability of employed specialists in the practice area in question).
b. *Does Figure 1 in Section II.A accurately describe the activities for which the firm uses the work of a specialist? What other specialized knowledge and skill do specialists have and in what areas of the audit is their work commonly used?*

We believe Figure 1 in Section II.A accurately describes the activities for which the firm uses the work of a specialist. Other areas of the audit in which valuation actuaries may be involved include warranty obligations, outstanding loyalty reward points, gift card breakage, net asset values of funds with securitized insurance contracts, and customer refunds.

c. *What type of work do the specialists perform? Does the type of work vary depending on whether the firm employs or engages the specialist? Does the type of work vary depending on the specialist’s field of expertise?*

The type of work varies significantly by level of audit materiality; risk assessment and associated uncertainty, especially relative to the size of the entity and the size of the item being reviewed; and nature of the coverage provided. In some cases, independent estimates are necessary, while others require a review of the basis, methodology, assumptions, and documentation of management’s estimates.

d. *Is the auditor’s specialist more likely to assist in testing the company’s process or developing an independent estimate? Why?*

As indicated in our response to question 3.c., it depends upon the circumstances of the company and the risks involved. For actuaries it also may depend on practice area; for example:

- Actuaries practicing in the property and casualty field are more likely to produce an independent estimate given the nature of the methodologies used in this practice area.
- Actuaries practicing in the pension field are more likely to focus on the qualifications of the preparing actuary and the reasonableness of the assumptions reflected in the measurements.

4. *For accounting firms that use the work of an auditor’s employed specialist:*

a. *Does supervising the work of employed specialists in accordance with Auditing Standard No. 10 present any challenges?*

We believe that supervising the work of employed specialists in accordance with Auditing Standard (AS) No. 10 does present challenges. These include: an assessment of the credentials, knowledge, and experience of an actuary; the quality and timeliness of the communication between the specialist and supervisor; and the experience in the area of the assigned supervisor.

b. *How does the firm evaluate whether the work was performed and whether the results of the employed specialist’s work support the conclusions reached?*

A great deal of communication between the auditor and specialist is required, as is a detailed review of the specialist’s processes and findings by the auditor.
c. Does this evaluation vary by the nature of the specialization and degree of the auditor’s familiarity with that particular specialization?

We do not have a response to this question at this time.

d. How would the evaluation change if the firm engaged the specialist?

We do not have a response to this question at this time.

e. What is the process for determining whether more senior specialists in the firm, such as partners or principals, should assist the auditor in supervising the work of the specialist? How does that assistance affect the auditor’s supervision of the work of the employed specialist?

We do not have a response to this question at this time.

5. For accounting firms that use the work of an auditor’s engaged specialist:
   a. What process does the firm use to assess the knowledge and skill of a specialist before engaging the specialist?

We believe the process usually includes an interview of the individual(s) or firm expected to be involved, together with assessment of qualifications and prior similar work of the person in charge of conducting the review.

b. Are there circumstances when the auditor performs procedures in addition to those specified in AU sec. 336 to evaluate the work of the specialist (e.g., performs procedures similar to those in Auditing Standard No. 10)? If so, describe those circumstances and the reasons for using that approach. Do senior specialists in the firm (if any), such as managers and partners, assist in evaluating the engaged specialist’s work?

Circumstances when the auditor may perform additional procedures can include analytics, such as trends of relevant ratios of reserves or other recommended values or experience.

c. How does the firm apply the requirements of AU sec. 336, in conjunction with the risk assessment standards, to the use of the work of an engaged specialist?

Although practice varies, procedures specified in AU 336 are followed.

d. In using the work of an engaged specialist, does the firm have access to all the methods and models of that specialist or are there instances when access to proprietary methods or models is restricted by the specialist or the specialist’s employer?

There are times in which proprietary methods/models are used. The acceptability of this practice depends on the coverage involved, model validation procedures, a review of prior
use of the models/methods with other clients, and a review of the assumptions used in the model with respect to consistency with prior periods and overall reasonableness.

For additional details, please see our response to question 8.b. below.

6. For accounting firms that use the work of a company’s specialist:
   a. What are the circumstances in which the firm uses the work of a company’s specialist? If so, describe the related audit procedures performed in connection with the specialist's work. Are there circumstances when the auditor performs procedures in addition to those specified in AU sec. 336 to evaluate the work of the specialist? If so, describe those circumstances and the reasons for using that approach.

   A firm may use the work of a company’s specialist if the risk of misstatement is not material, the estimate involved is a very straightforward calculation, or there has been no change made in methods/assumptions since the most recent review by the auditor’s specialist was conducted.

   b. Does Figure 1 in Section II.A accurately describe the activities for which the auditor uses the work of a company’s specialist? Are there other activities in which the auditor uses the work of a company’s specialist that should be considered within the scope of this project?

   Figure 1 reasonably describes the activities in which an auditor uses the work of a company specialist. In the case of some entities, a corporate actuarial department may perform its own validation of assumptions and methods used by the actuaries who provide measurements of reserves or other obligations for management.

   c. In what circumstances has the firm concluded that the findings of the company’s specialist were unreasonable and therefore performed additional procedures, as required by AU sec. 336? In those circumstances, what procedures did the auditor perform?

   We do not have a response to this question at this time.

   d. How does the firm currently apply the requirements of AU sec. 336, in conjunction with the risk assessment standards, to the use of the work of a company’s specialist?

   We do not have a response to this question at this time.

   e. Are there any differences between how the firm uses the work of a company’s employed specialist and a company’s engaged specialist?

   Overall, there is little difference in procedures followed when the firm uses the work of a company’s employed specialist and a company’s engaged specialist, although the validation of the qualifications of external actuaries are performed each time these actuaries are utilized, while the qualifications of internal actuaries are assumed because of prior validation.
7. **This section provides the staff’s views about the need to improve the standards based on issues related to the standards, inspections observations, and the views of the SAG. Do commenters agree with the staff’s analysis of the need to improve standards? Are there other issues the staff should consider with respect to this need?**

In general, we suggest adopting clearly stated principles-based standards. More explicit guidance relating to the use of an actuary as a specialist, possibly emphasizing the importance of assumptions/selection of parameters used by life and pension actuaries, and enhanced guidance with respect to the audit of the underlying data used by the actuary could be useful. We note the statement made in the consultation paper that specialists generally do not have training regarding skepticism—this may be true for certain specialists not employed by the audit firm, but an actuary’s training is geared to skeptical analysis.

8. **When an auditor obtains an understanding of the methods used by the company’s specialist:**
   a. **If the auditor has access to the specialist’s methods (or models), is that access at a sufficiently detailed level (as opposed to a general level, such as a website description) to allow the auditor to obtain sufficient appropriate audit evidence?**

In general, the auditor has access to sufficiently detailed descriptions of methods, assumptions, and audit outputs that should enable the auditor to obtain appropriate audit evidence. The time used for this purpose varies widely, depending on the auditor’s experience with the risks and actuarial methods involved. The actuary should take the time to explain the procedures followed (in sufficient detail as warranted by the auditor’s assessment of and experience with the risks) and assumptions made, although it depends on the significance of the item being discussed. The increased use of specialized valuation software may limit the auditor’s direct access to the methods or models used by the actuary.

   b. **If the auditor does not have such access, how does the auditor obtain sufficient appropriate audit evidence regarding the relevant assertion?**

Usually, the auditor discusses the trends in estimates with the actuary involved (either the auditor’s actuary or management’s actuary) and seeks to understand any changes between the accounting values and the actuary’s audit range. The auditor also seeks to understand the factors underlying the year-over-year change in the assertion.

The actuary also may provide the auditor with a set of output exhibits when direct access to methods/models is not possible due to software licensing arrangements. The auditor may review the reasonableness of the model by sensitivity testing the key inputs into the model and examining the outputs provided by the company.
9. Are revisions to PCAOB standards the most appropriate way to address the issues as discussed in this staff consultation paper? Are there other alternatives that should be considered?

The revisions to PCAOB standards are appropriate to address the issues discussed in this paper. Performing an implementation review of relevant PCAOB standards similar to that made by the IAASB may provide further insight into where revisions are needed. Nevertheless, pursuing ways to enforce the current standards may be more tenable than revising current standards.

10. Should the auditor perform the same procedures when using the work of an auditor’s engaged specialist as those required for an auditor’s employed specialist?

In general, similar procedures are applicable. However, because of prior work relationships, certain procedures regarding validating qualifications of the auditor’s employed specialists do not need to be repeated, other than to validate continuing education compliance.

11. Are there other considerations related to the alternatives presented that the staff should be aware of?

We do not have a response to this question at this time.

12. Are there other alternatives related to the auditor’s use of the work of an auditor’s specialist that would result in the consistent treatment of the work of an auditor’s employed and engaged specialist? If so, explain the other alternatives.

We do not have a response to this question at this time.

13. Are there any limitations on an auditor’s ability to treat the work of an engaged specialist the same way as that of an employed specialist?

We are not aware of any limitations on an auditor’s ability to treat the work of an engaged specialist in the same way as that of an employed specialist.

14. Is it appropriate for an auditor to consider the knowledge, skill, and objectivity of a company’s specialist when evaluating the reliability of information provided by that specialist? If so, how might the company’s use of the work of a competent and objective specialist under the potential alternatives affect the nature, timing, and extent of the auditor’s procedures?

We believe it is appropriate for an auditor to consider the knowledge, skill, and objectivity of a company’s specialist when evaluating the reliability of information provided by that specialist. However, it should not affect the auditor’s procedures.
15. How do auditors currently obtain an understanding of the assumptions and methods used by a specialist under AU sec. 336?

Auditors currently obtain an understanding of the assumptions and methods used by a specialist under AU 336 by ensuring the specialist understands his or her role. The auditor may want to undertake a discussion of the documentation of the specialist’s findings with respect to methods and assumptions made.

Audit and company specialist actuaries typically invest time helping auditors understand the material effects of various assumptions/methods, the sensitivity in the result to changes in key assumptions, and other key risks and uncertainties in the estimate. Actuaries also are required to disclose many of these items by our ASOPs in communications with the principal user of our work product.9

As noted on page 30 of the staff consultation paper, “[i]n cases when the auditor does not possess the specialized knowledge or skill to perform those more rigorous procedures, the auditor might need to employ or engage his or her own specialist.” This generally would be the case when reviewing a company’s obligations for pensions and other postretirement benefit plans or for insurance liabilities.

In a situation in which the auditor’s specialist is reviewing information provided by the company’s specialist, the auditor’s specialist should perform testing sufficient to confirm whether the methods, assumptions, and results are reasonable. The test of reasonableness may be accomplished by reviewing appropriately documented actuarial communications provided by the company’s specialist, testing census data and assumptions, independently estimating the balance in question, etc. It should not require the auditor’s specialist to reproduce the company’s specialist’s work in most cases.

When determining what level of testing the auditor should perform on information provided by the company’s specialist, it is important to establish appropriate limits on the amount of testing required so that the testing is not unduly burdensome. For example, in reviewing a company’s obligations for pensions and other postretirement benefit plans, it would be unnecessary to require the auditor to reproduce the work of the company’s specialist. Instead, it would be more appropriate to require the auditor (or its specialist) to evaluate the reasonableness of significant assumptions and appropriateness of methods used by a company’s specialist.

The large auditing firms already employ in-house actuarial specialists or engage actuarial specialists. These auditor’s specialists generally review the methods, assumptions, data, etc. used by the company’s actuary specialist to ensure that they are reasonable and appropriately documented. They also provide the audit engagement team with a detailed report summarizing their review and conclusions. The staff consultation paper does not appear to specifically address a situation in which both the company and the auditor use their own

specialists, but it is a very common situation for actuarial specialists. The use of auditor’s specialists may be less common among smaller auditing firms.

16. Should the work of a company’s specialist be treated as audit evidence the same way as other information provided by the company? Are there concerns associated with more rigorous testing of the work of a company’s specialist that may result from this approach? For example, would auditors increasingly need to employ or engage specialists to perform work to assist the auditor with such testing?

The work of a company’s specialist should be treated as audit evidence in the same way other information provided by the company is used. As risks to which companies are exposed continue to become more complex, the need for employed or engaged specialists’ review will likely increase on the audit.

17. Are there other alternatives that would be a more appropriate response to the risks of material misstatement in areas where companies use the work of specialists? If so, what are those alternatives?

We do not have a response to this question at this time.

18. Are there any practical concerns with rescinding AU sec. 336? The staff is especially interested in the views of auditors, companies that typically use the work of specialists, and specialists, including those in specialized industries (such as oil and gas and environmental engineering). Are there other challenges associated with testing the work of a company’s specialist?

To the extent that the auditor does not recognize the risks involved or does not understand the description of the procedures, methods, and assumptions used by the company/company specialists, the auditor will continue to need to rely on the work of and communication with the auditor’s specialists. However, the auditor needs to remain informed about the methods and assumptions used and conclusions reached. The auditor must understand the work of both the company’s specialist and her/his own specialist. The auditor will need to continue to document the basis for her/his agreement or disagreement with the specialists’ conclusions.

19. Are the potential definitions of an auditor’s specialist and a company’s specialist appropriate? If not, what would be alternative definitions for those terms?

The potential definitions of an auditor’s specialist and a company’s specialist are appropriate. We encourage definitions to be consistent with those used by the IAASB.

20. Is it appropriate to retain the definition of a specialist from AU sec. 336 or is there a need to update the definition to reflect the increased use of the work of persons with specialized knowledge or skill in accounting and auditing? For example, should that definition also include those with specialized knowledge or skill in income taxes or IT?

We do not have a response to this question at this time.
21. Is it clear what constitutes a specialized area of accounting and auditing? For example, are persons with specialized knowledge or skill in regulatory compliance (e.g., related to audits of brokers and dealers) considered to be persons with specialized knowledge or skill in accounting and auditing? Should the staff provide clarification about what constitutes a specialized area of accounting and auditing? Does the discussion in this staff consultation paper appropriately describe when third parties may be inside or outside the scope of the potential definition of an auditor’s specialist?

We do not have a response to this question at this time.

22. Are the potential requirements to evaluate the knowledge and skill of an auditor’s specialist clear and appropriate? Are there other alternatives to accomplish the objectives? Are there other factors that the auditor should consider?

We recommend emphasizing the importance for actuaries to hold professional credentials associated with current membership of an actuarial body, as described in our general comments.

23. Are the matters described in the potential requirements on which the auditor and an auditor’s specialist should reach an agreement sufficient and appropriate? If not, what other matters should be required to be specified in the agreement before the auditor’s specialist performs work to assist the auditor?

The matters described in the potential requirements on which the auditor and an auditor’s specialist should reach an agreement are both sufficient and appropriate.

24. Are there any obstacles to reaching an agreement and documenting all of the categories of information described in the potential requirements? Would it be difficult to comply with some of the potential requirements? Are there other alternatives to accomplish the objectives?

We have not identified any further obstacles. We emphasize that the methods of validating estimates differ by the type of estimate. For example, the re-performance of reserves for life insurance as calculated is valuable. For property and casualty insurance, independent estimates of total claim reserves may be important. In other words, the choice of method(s) used to ensure sufficient appropriate audit evidence is obtained continues to be important and vary by circumstance and the nature of the items being assessed.

25. Could the potential requirements for informing the auditor’s engaged specialist of his or her responsibilities and reviewing the specialist’s work and conclusions result in unintended consequences (e.g., tax or employee benefit consequences)?

We do not foresee any unintended consequences, but we are concerned about whether an audit firm is able to extend supervisory authority over an employee of another firm or that employee’s work product. Relinquishing control of one’s employees to an audit firm, while
retaining the legal risk associated with those employees, could result in some specialist firms refusing to provide audit assistance. This issue could be mitigated if the employer includes a requirement in the engagement letter that the contracted specialist may provide the audit firm with copies of work papers and access to the preparers as appropriate.

26. **How do accounting firms determine what information an auditor’s specialist should provide to the auditor? Are there circumstances in which auditors may not retain all audit evidence obtained from the specialist?**

The auditor determines what information an auditor’s specialist should provide to the auditor based on the risks and materiality involved and the nature of the item being assessed. The auditor has to determine what information is necessary to form a conclusion regarding whether the information provided forms an adequate basis to conclude whether the information provided in relation to the item being assessed constitutes sufficient appropriate audit evidence.

27. **Do the potential requirements appropriately reflect what the auditor’s responsibilities should be when an auditor’s specialist develops an independent estimate? How would these potential requirements differ from current practice (e.g., for audits performed in accordance with ISA 620 or AU-C Section 620)?**

The potential requirements appropriately reflect what the auditor’s responsibilities should be when an auditor’s specialist develops an independent estimate.

28. **Do the potential requirements appropriately reflect what the auditor’s responsibilities should be when an auditor’s specialist tests the company’s methods and significant assumptions? How would these potential requirements differ from current practice (e.g., for audits performed in accordance with ISA 620 or AU-C Section 620)?**

The potential requirements appropriately reflect what the auditor’s responsibilities should be when an auditor’s specialist tests the company’s methods and significant assumptions.

29. **Do the potential requirements appropriately reflect what the auditor’s responsibilities should be when the auditor evaluates the results and conclusions of the work of an auditor’s specialist? How would these potential requirements differ from current practice (e.g., for audits performed in accordance with ISA 620 or AU-C Section 620)?**

The potential requirements appropriately reflect what the auditor’s responsibilities should be when the auditor evaluates the results and conclusions of the work of an auditor’s specialist.

30. **Do the potential requirements provide appropriate direction for the auditor’s consideration of any limitations, restrictions, and caveats in the report of an auditor’s specialist?**

The potential requirements provide appropriate direction for the auditor’s consideration of any limitations, restrictions, and caveats in the report of an auditor’s specialist.
31. Are the potential requirements for evaluating the work of an auditor’s specialist appropriate for all types of specialists used in audits (e.g., valuation specialist, actuary, geologist, lawyer, or engineer)? If not, how should the potential requirements be tailored?

The requirements for evaluating the work of an auditor’s specialist should be tailored based on the risk of material misstatement and the factors outlined in our opening comments. This would include the professional accreditation of the specialist, their experience relative to the balance being tested, and their association or organization’s code of conduct, standards of practice, and continuing education requirements.

32. How does the auditor evaluate relationships between an auditor’s engaged specialist and a company under AU sec. 336?

We do not have a response to this question at this time.

33. Are the potential requirements under the enhanced objectivity approach for the auditor’s use of the work of an engaged specialist appropriate and feasible?

Given the size, scope, and operating structure of many consulting firms, it would be impractical to establish independence in most cases. We believe that such independence requirements may be onerous in some cases, as the tracking systems may not be in place for everyone in the chain of command, reducing the willingness of certain consulting firms to make their resources available to the auditor.

It is important to establish the objectivity of engaged specialists with respect to the company. We would favor the concept of enhanced objectivity outlined in the consultation paper as it applies to the individual specialist and his or her team working on the engagement and not the specialist’s employer in the circumstances noted in our response to question 35.

34. Should the auditor’s engaged specialist (and his or her employer) be required to meet the independence criteria of Rule 2-01? Are there certain types of specialists that would not be able to satisfy these criteria? Could these criteria affect the availability of specialists?

Requiring independence in the accounting sense for engaged specialists is not practical. However, independence in a general sense is important, as described in annotation 6-1 in the actuarial profession’s code of conduct:

“An Actuary who is not financially and organizationally independent concerning any matter related to the performance of Actuarial Services should disclose to the Principal any pertinent relationship that is not apparent.”

In the case of the auditor’s engaged specialist, the Principal would be the audit firm. We also believe that objectivity is important.
35. Are the potential requirements for the auditor to obtain information regarding business, employment, and financial relationships between the auditor’s specialist (including his or her employer) and the company appropriate? If not, should other relevant factors be added to the potential enhanced objectivity requirements? For example, should the potential requirements take into account information barriers or other controls to address conflicts of interest at a specialist’s firm?

Some aspects of the potential requirements for the auditor to obtain information regarding business, employment, and financial relationships between the auditor’s specialist and the company may be impractical (e.g., the tracking of all business relationships with a specific company may not be possible for a non-audit firm). However, it is appropriate for the auditor to identify whether any of these relationships exist for the individual specialist in charge of the consulting assignment. One option might be a simplified approach whereby the auditor asked for consulting fees from the audited company in the last fiscal year of the consulting firm as a percentage of the specialist’s firm total consulting fees. The request could be made in broad bands (e.g., less than 5 percent, 5-10 percent, or greater than 10 percent).

36. Are the potential requirements for the auditor to evaluate the objectivity of an auditor’s specialist appropriate? Is it appropriate to apply the reasonable investor test as an overarching principle in assessing the specialist’s objectivity? If not, are there other relevant factors that would be helpful to add to the potential requirements? For example, should the potential requirements take into account “threats” to objectivity and “safeguards” to reduce the threats, as provided in ISA 620?

We do not have a response to this question at this time.

37. Does the enhanced objectivity approach provide sufficient assurance that the work of an auditor’s engaged specialist will not be influenced by business, employment, or financial relationships?

If the enhanced objectivity approach is adopted, no additional rules are needed. We note that Precept 1 of the actuary’s code of conduct mandates performing engagements with integrity:

“An Actuary shall act honestly, with integrity and competence, and in a manner to fulfill the profession’s responsibility to the public and to uphold the reputation of the actuarial profession”

We believe objectivity is a key element of integrity.
38. **Is the potential requirement that the auditor obtain information about the process used by the auditor’s engaged specialist to formulate the responses to the auditor’s request for information appropriate and sufficiently clear? If not, are there other relevant factors that would be helpful to add to the potential requirement?**

The potential requirement that the auditor obtain information about the process used by the auditor’s engaged specialist to formulate the responses to the auditor’s request for information is appropriate and sufficiently clear.

39. **Does the specialist (or his or her employer) typically have a system in place capable of tracking the information to respond to the auditor’s request? If not, could a system feasibly be created?**

It is unlikely that engaged specialists (other than those employed by another audit firm) would have a system in place to track this information. It may not be feasible or cost-effective for the consulting firm to build one.

40. **For accounting firms that use the work of an auditor’s or a company’s specialist for public company audits:**
   
a. **In how many (e.g., what percentage) of those audits is the work of specialists used?**
      
      Provide details within the following categories:
      
i. Auditor’s employed specialists;

      ii. Auditor’s engaged specialists;

      iii. Company’s employed specialists; and

      iv. Company’s engaged specialists.

   
   We do not have a response to this question at this time.

   
b. **For the auditor’s specialists described in a.(i) and a.(ii), what is the ratio of specialist hours to total audit hours?**

   The ratio of hours of a specialist to those of the total audit varies.

   
c. **How are the auditor’s engaged specialists compensated?**

   Compensation for engaged specialists can either be on a fixed fee or on a rate per hour, depending on the arrangement.

41. **What are the likely economic impacts, including benefits and costs, of the potential alternatives discussed in this staff consultation paper? Are there any unintended consequences not already identified that might result from the alternatives?**

   We do not have a response to this question at this time.
42. To what extent would the potential alternatives help to improve audit quality or reduce the incidence of undetected misstatements, audit deficiencies, and fraud?

Overall, we believe that it is more important to ensure that existing standards are applied rather than adding additional standards.

43. Would any of the potential alternatives lead to increased cost? If so, what are the estimated (i) number of audits affected and impact on audit hours and cost and (ii) effects on companies’ costs?

We do not have a response to this question at this time.

44. Do the incremental costs associated with any of the potential alternatives decline as an accounting firm uses specialists more frequently?

We do not have a response to this question at this time.

45. Are the costs of the potential alternatives likely to be reduced in years after the year of initial implementation?

After the initial education of auditors on the new rules, it is possible there would be additional costs, but we do not believe they would be appreciable.

46. Are the economic impacts of the potential alternatives likely to be different for audits involving (i) emerging growth companies, (ii) brokers and dealers, (iii) companies in specialized industries, (iv) companies in certain stages of their life cycles (e.g., development stage), and (v) the use of the work of specialists in specific fields of expertise? If so, provide relevant details.

We do not have a response to this question at this time.

47. Are the economic impacts of the potential alternatives likely to affect accounting firms of different sizes differently? If so, provide relevant details. Are there other alternatives that might address the need for improvement noted in this staff consultation paper at lower cost or greater efficiency?

Smaller audit firms tend to rely on engaged specialists to a greater extent than employed specialists. However, smaller audit firms also tend to have clients that require fewer special needs. Most entities are audited by large audit firms that typically employ specialists.
48. As part of considering the need for change, the staff is analyzing academic literature that relates to the auditor’s use of the work of a specialist. Is there ongoing research or other information, other than that identified in this staff consultation paper, that the staff should consider in evaluating the economic aspects of changes in standards for the auditor’s use of the work of a specialist?

PCAOB staff should be familiar with ASOP No. 21, Responding to or Assisting Auditors or Examiners in Connection with Financial Statements for All Practice Areas.¹⁰

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Thank you for the opportunity to provide feedback to the PCAOB Staff Consultation Paper 2015-01, The Auditor's Use of the Work of Specialists. If you have any questions or would like to discuss these issues in more detail, please contact Lauren Sarper, the Academy’s senior policy analyst for risk management and financial reporting, at 202-223-8196 or sarper@actuary.org.

Sincerely,

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