

May 25, 2005

**Mr. James Sylph**  
Technical Director  
International Auditing and Assurance  
Standards Board  
545 Fifth Avenue  
New York, NY 10017

Dear Mr. Sylph:

**RE: Recommendation from the Auditing Standards Board to the International Auditing and Assurance Standards Board: Use of Specialists**

Dear Mr. Sylph:

At its February 1-3, 2005 meeting, the Auditing Standards Board (ASB) approved the submission to the International Auditing and Assurance Standards Board (IAASB) of the accompanying Use of Specialists recommendation. The recommendation consists of two draft documents entitled: *Using an Outside Specialist to Assist in the Audit* (Auditor's Specialist) and *Using the Work of Management's Nonemployee Specialist* (Management's Specialist). We understand that the IAASB recently added to its agenda a project to revise International Standard on Auditing (ISA) 620, *Using the Work of an Expert*, and this recommendation is intended to assist the IAASB in this project.

The purpose of this letter is to provide you with a description of the background of the ASB project and commentaries on matters that the ASB wishes to bring to your attention.

**Background**

In 2003, the ASB's Audit Issues Task Force formed a task force to review and propose revisions to Statement on Auditing Standards (SAS) No. 73, *Using the Work of a Specialist*. This project was undertaken because with the complexity of the environments and transactions under audit, both management's and the auditor's use of specialists has increased and evolved since the issuance of SAS No. 73. Also, during the development of the auditing standards that have been recently issued (either as exposure drafts or final

SASs), the ASB and its task forces expressed concerns regarding the consistency and sufficiency of auditing guidance on the use of specialists. Some of the concerns stemmed from the various roles of a specialist (member of the engagement team, consultant to the auditor, independent [not a related party] consultant to the client, or employee of the client) and the nature and extent of audit work necessary when the auditor intends to rely on the work of a specialist. Other concerns related to the use of specialist in areas that may be very complex such as information technology, fair value measurements, and valuations in highly specialized industries.

Specifically, the project:

- Addressed an apparent inconsistency or ambiguity in the auditing standards. The guidance on the use of specialists in SAS No. 101, *Auditing Fair Value Measurements and Disclosures*, is more explicit than the auditing guidance in SAS No. 73 and therefore seems inconsistent with SAS No. 73. Specifically, SAS No. 101 requires auditors to *test* the assumptions and methods used by the specialist whereas SAS No. 73 requires auditors to *understand* the assumptions and methods used by the specialist.
- Clarified when a specialist is part of the engagement team and subject to the firm's quality control system and independence requirements. SAS No. 73 excludes from its scope those specialists who are *employed* by the audit firm and participate in the audit (in-firm specialists are always considered part of the engagement team and fall under the scope of SAS No. 22, *Planning and Supervision*). However, SAS No. 73 did not address situations when specialists are *engaged* by the auditor and effectively function as part of the engagement team.
- Developed overall concepts regarding the use of specialists and consolidate all auditing guidance on use of specialists into one standard. Currently, SAS No. 73 addresses the use of specialists (auditor's and management's) only when performing substantive tests. SAS Nos. 22 and 94, *The Effect of Information Technology on the Auditor's Consideration of Internal Control in a Financial Statement Audit* contain the guidance on the auditor's use of specialists, including outside specialists, in other phases of the audit such as, when assessing information technology risks.

### **Matters for your Attention**

*Development of Separate Standards for Management's Specialist and the Auditor's Specialist*—the ASB believes it is important to distinguish between how the auditor tests the work performed by management's nonemployee specialist, and how the auditor uses a specialist to assist in conducting the audit. Specifically, the ASB wanted to be clear that whenever management hires a specialist, the auditor must take certain steps and apply certain auditing procedures to that specialist's work, regardless of the specialist's reputation and competency. In other words, the auditors cannot rely on the specialist's work merely because he or she is not an employee. In addition, the ASB wanted to provide guidance to auditors, especially those in smaller firms that do not have a variety

of special expertise within the firm, as to how to use a specialist to assist in conducting the audit, especially when that specialist does not function as a member of the engagement team. Regardless of whether these standards remain separate, the ASB strongly believes the guidance needs to retain the separation between the two types of specialists.

*Definition of a Specialist*—A specialist is defined in paragraph 1 of the Auditor’s Specialist recommendation as “a person or firm possessing specialized skill or knowledge in a particular field other than accounting, auditing or taxation.” This definition is based on SAS No. 1, *Training and Proficiency of the Independent Auditor* (see footnote 2). The task force’s position is that in some situations an auditor has the ability to acquire other complementary skills such as, business valuation or information technology, enabling the auditor to possess the skills or knowledge to be a specialist. However, other specialists such as, engineers and geologists have the training and experience which are out of the scope of the auditor’s training and proficiency. These are the type of specialists contemplated in this recommendation.

*Definition of Audit Firm*—Paragraph 2 of the Auditor’s Specialist recommendation defines an audit firm as follows:

A firm is a form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the American Institute of Certified Public Accountants that is engaged in the practice of public accounting. Except for purposes of applying Rule 101: *Independence* [ET section 101.01], the firm includes the individual partners thereof.<sup>1</sup>

At its February 2005 meeting, the ASB raised the issue whether the proposed definition set forth above includes firm structures such as, affiliations or associations. The AICPA definition of an audit firm was intended for U.S. jurisdictional purposes and was not intended for such firm structures. This matter might be more of an issue at the international level.

*Determining Whether the Outside Specialist is Effectively Functioning as a Member of the Engagement Team*—This is an issue that was subject to considerable debate at the ASB. One argument was whether the ASB should provide mandatory guidance in this area that would dictate the auditor that in certain situations in which the audit evidence provided by the outside specialist is so pervasive that he or she must be considered part of the engagement team. The other argument was that instead of providing mandatory guidance, the standard should provide criteria to the auditor that he or she should evaluate in determining whether the specialist should be part of engagement team or not. This would allow the auditor more flexibility in making his or her determination.

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<sup>1</sup> See AICPA’s Statement on Quality Control Standards No. 2, *System of Quality Control for a CPA’s Firm Accounting and Auditing Practice*.

There are situations in an audit engagement when the outside specialist provides the principal evidence in support of significant assertions, accounts or disclosure (for example, an actuary who is assisting the auditor in calculating the pension liability). In these situations, the ASB considered making the guidance mandatory that the specialist must be considered a member of the engagement team. However, some members questioned, from an audit quality perspective, the significance of whether the outside specialist is on the engagement team or not. Secondly, some members expressed the view that dictating when an outside specialist must be on the audit team and thereby forcing the outside specialist to comply with professional ethical requirements (e.g. independence), would be prejudicial to smaller audit firms, who unlike the larger firms, may not have the resources of various specialties in-house.

As a result of the issues noted above, the ASB's conclusion was to provide criteria that the auditor should evaluate in determining whether the outside specialist must be considered part of the audit team. It is the ASB's view that the determination whether the specialist is part of the engagement should be a judgment decision that the auditor should make based on the facts and circumstances of the engagement encountered by the auditor.

Paragraph 7 of the Auditor's Specialist recommendation provides a criterion that the auditor should evaluate in determining when an outside specialist should be considered part of the audit team. The criterion states that when an outside specialist provides the principal evidence supporting the significant financial statement amount, assertion or disclosure the outside specialist should be considered a member of the engagement team. The ASB considered other criteria, such as, 1) the auditor has the ability to effectively direct, supervise, and review the specialist's work, 2) the agreement with the specialist is such that the auditor will direct, supervise, and review the specialist's work, and retain documentation supporting the specialist's findings, and 3) the specialist is independent of the entity whose financial statements are under audit and the specialist agrees to abide by the firm's quality control system. These criteria were eliminated because the ASB did not consider them as evaluative criteria, but rather they represent stipulations of the engagement between the auditor and the outside specialist.

*Evaluating the Objectivity of the Outside Specialist Who is not a Member of the Engagement Team*—The ASB debated whether to require the auditor to evaluate the outside specialist's independence when the specialist is not effectively functioning as a member of the engagement team (an outside specialist considered to be on the engagement team must be independent). Because in audits of many nonissuers<sup>2</sup> it might be difficult to find a specialist who is independent of the auditee (using the independence criteria in the AICPA's *Code of Professional Conduct*), the ASB decided to carry forward the guidance in SAS No. 73 and only require an evaluation of the specialist's objectivity.

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<sup>2</sup> The term "issuer" represents entities required to be registered and file periodic filings with the U.S. Securities and Exchange Commission (SEC). Nonissuers represent entities not subject to SEC rules and regulations or the Sarbanes-Oxley Act of 2002.

*Internal Controls to Evaluate Management's Specialist Work*—Paragraph 4 of the Management's Specialist recommendation states that management may engage specialists in certain situations. The ASB raised the issue that in these situations, the entity should have internal controls implemented to evaluate the sufficiency and the competence of the specialist's work. This is particularly important when the entity engages a specialist who is employed by the auditor and the independence issues that management and the auditor should consider.

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Members of the ASB, the task force, or staff would be pleased to assist you as IAASB undertakes this project. If you have any questions or comments, please contact me by telephone at (212) 596-6011 or by email at [hhasty@aicpa.org](mailto:hhasty@aicpa.org).

Very truly yours,

Hiram Hasty

Hiram Hasty  
Technical Manager

Cc: John A. Fogarty  
Craig Crawford  
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Use of Specialists Task Force

Enclosures