



# CENTER FOR AUDIT QUALITY

*Serving Investors, Public Company Auditors & the Markets*

August 30, 2017

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Office of the Secretary  
Public Company Accounting Oversight Board  
1666 K Street, NW  
Washington, DC 20006-2803

**Re: PCAOB Release No. 2017-002, Rulemaking Docket Matter No. 043: Proposed Auditing Standard – Auditing Accounting Estimates, Including Fair Value Measurements, and Proposed Amendments to PCAOB Auditing Standards**

Dear Office of the Secretary:

The Center for Audit Quality (“CAQ”) is an autonomous public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. The CAQ fosters high quality performance by public company auditors; convenes and collaborates with other stakeholders to advance the discussion of critical issues requiring action and intervention; and advocates policies and standards that promote public company auditors’ objectivity, effectiveness, and responsiveness to dynamic market conditions. Based in Washington, DC, the CAQ is affiliated with the American Institute of CPAs.

The CAQ appreciates the opportunity to share our views and provide input on the Public Company Accounting Oversight Board’s (PCAOB or Board) Proposed Auditing Standard, *Auditing Accounting Estimates, Including Fair Value Measurements* (the Proposal or Proposed Standard) and amendments to other PCAOB auditing standards. This letter represents the observations of the CAQ but not necessarily the views of any specific firm, individual, or CAQ Governing Board member.

Similar to views previously expressed on this topic, the CAQ applauds the PCAOB’s efforts to consider ways to promote strengthened auditing practices and update the standards considering recent developments in an area of the audit that is of increasing prevalence and significance.<sup>1</sup>

<sup>1</sup> See page 1 of the Proposal.

In response to the PCAOB's standard-setting project in this area related to auditing accounting estimates, including fair value measurements and the auditor's use of the work of specialists, the CAQ has submitted to the PCAOB multiple comment letters,<sup>2</sup> as well as *Auditing Accounting Estimates and Fair Value Measurements: A Framework* (the Framework).<sup>3</sup> The Framework represents a collaborative effort by members of the profession to provide the PCAOB with our views as it relates to the Board's current standard-setting projects in this area.

To be operational in today's capital markets—and to evolve in those markets—the Framework is principles-based. Principles guiding the framework that state any enhancements to the existing auditing standards for auditing accounting estimates should:

- Recognize the relationship between the auditor's risk assessment and the audit procedures designed to sufficiently and appropriately respond to that risk;
- Consider the range of accounts (and elements of accounts) that involve varying levels of estimation uncertainty and the varying levels of complexity in measurement and risk associated with different accounting estimates;
- Recognize that accounting estimates may be subject to a significant degree of measurement uncertainty, and such inherent uncertainty will exist irrespective of the level of effort involved in auditing the accounting estimate (e.g., not imply that a level of precision exists in an inherently imprecise measurement exclusively as a result of an audit of that measurement); and
- Continue to recognize that auditors may use the work of a specialist when situations arise that require specialized knowledge and subject matter expertise in a field other than accounting or auditing.

While the Proposal incorporates many of these concepts in the Framework, we offer for the Board's consideration our views regarding certain topics outlined in the Proposal. Our views are organized into the following sections:

- I. Objective of the Proposed Standard
- II. Identifying and Assessing Risks of Material Misstatement
- III. Valuation of Investments Based on Investee Financial Condition or Operating Results
- IV. Audit Evidence
- V. Other Matters
- VI. Applicability
- VII. Effective Date
- VIII. Conclusion

## **I. Objective of the Proposed Standard**

The objective of the Proposed Standard would require the auditor to "...obtain sufficient appropriate audit evidence to determine whether accounting estimates are reasonable in the circumstances, have been accounted for and disclosed in conformity with the applicable financial reporting framework, and are free

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<sup>2</sup> See the following CAQ comment letters submitted to the PCAOB on this topic: [Auditing Accounting Estimates Letter](#) (November 3, 2014), [PCAOB: The Auditor's Use of the Work of Specialists](#) (July 31, 2015), [Auditing Accounting Estimates and Fair Value Measurements - A Framework](#) (December 1, 2015).

<sup>3</sup> The Framework, *Auditing Accounting Estimates and Fair Value Measurements: A Framework* can be found in the Appendix of the CAQ's comment letter submitted to the PCAOB and publicly available on [PCAOB's Docket 043](#).

from bias that results in material misstatement.”<sup>4</sup> Because the requirements for the auditor to consider bias are already outlined in the proposal, we do not believe that obtaining sufficient appropriate audit evidence to determine whether accounting estimates are **free from bias that results in a material misstatement** should be an explicit objective of the Proposed Standard.<sup>5</sup>

In the release text of the Proposed Standard, the Board notes that the Proposal is intended to strengthen PCAOB auditing standards to “...provide direction to prompt auditors to devote greater attention to addressing potential management bias in accounting estimates...”<sup>6</sup> Because estimates inherently include some degree of bias, auditors should obtain evidence to provide reasonable assurance that the estimate is reasonably stated and free from a material misstatement, in the context of the applicable financial reporting framework.

We believe that including the consideration of management bias in the objective of the standard could result in confusion regarding the extent of work intended to be performed by the auditor in accordance with the requirements of the PCAOB’s extant standards related to management bias and the requirements and considerations in the Proposed Standard. Potential bias should be a consideration when the auditor is evaluating the overall reasonableness of an accounting estimate.<sup>7</sup> As a result, we recommend the objective of the Proposed Standard be modified to remove “...and are free from bias that results in a material misstatement.”

## II. Identifying and Assessing Risks of Material Misstatement

### *Risk Assessment*

We are supportive of incorporating the risk assessment standards into the Proposed Standard to help focus auditors on estimates with greater risk of material misstatement when determining the nature, timing, and extent of testing procedures for auditing accounting estimates.<sup>8</sup> However, it is not clear in paragraphs .05 - .07 of the Proposed Standard how auditors would tailor their audit response to an estimate that represents a significant risk of material misstatement versus an estimate that represents a lower risk of material misstatement. We recommend that the Board make it more explicit in the Proposed Standard that auditors should consider the results of their risk assessment procedures when determining the nature, timing, and extent of their testing procedures.

In addition, while the Proposal describes the procedures that would be required to be performed under each of the three approaches the auditor could employ to respond to the risks of material misstatement, it does not address how auditors would consider the sufficiency of evidence obtained when using a combination of the approaches. For example, the auditor may use its independent estimate in combination with evidence obtained through evaluation of the work of the management specialist. The auditor may also use a sensitivity analysis to provide evidence that could reduce the scope of testing of the company’s estimate that is necessary to obtain sufficient, appropriate evidence. Providing clarification on how the auditor could evaluate

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<sup>4</sup> See paragraph .03 of proposed AS 2501.

<sup>5</sup> See paragraphs .09, .11, .15, and .18 of the Proposal.

<sup>6</sup> See page 3 of the Proposal.

<sup>7</sup> See section 2.5 of the Framework, *Consideration of Management Bias*.

<sup>8</sup> See page 19 of the Proposal.

evidence from a combination of approaches could help auditors design and execute more effective and efficient audit strategies.

#### *Responding to the Risks of Material Misstatement*

Because facts and circumstances of a specific accounting estimate may not always be related to the issuer's industry, we question if it improves risk identification, or is even appropriate, to require the auditor to evaluate whether management's methods are "appropriate for the nature of the related account or disclosure and the business, industry, and environment in which the company operates,"<sup>9</sup> beyond fair value measurements, as facts and circumstances of a specific accounting estimate may not always be related to the issuer's industry. For instance, it could be perceived that the auditor would be restricted from accepting methods that are considered outside the industry norm, even though these methods may be appropriate in certain issuer-specific circumstances. Furthermore, this language does not appear to allow for auditor judgment as it could be viewed as limiting the universe of acceptable methods to those that are within the industry norm, when we believe the evaluation should be made in context of the requirements of the applicable financial reporting framework. It may be more appropriate for business, industry, and environmental considerations to be factors to consider in the auditor's overall evaluation of an accounting estimate, rather than a required evaluation in and of itself. We recommend that paragraph .10b of the Proposal be revised to read as follows: "Appropriate for the nature of the related account or disclosure." Additionally, we recommend that a second note be added to paragraph .10 of the Proposal along the lines of: "Evaluating whether the methods are appropriate for the nature of the account may include, but not be limited to, considering the business, industry, and environment in which the company operates."

The Proposed Standard provides auditors with factors that are relevant to the identification of significant assumptions.<sup>10</sup> These factors will aid auditors in developing an understanding of the "inventory" of assumptions underlying management's accounting estimate(s). However, paragraph .15e of the Proposed Standard on its own could result in auditors determining that all assumptions underlying an estimate are significant. We recommend the Board include a clarifying note in paragraph .15 of the Proposed Standard that describes how the factors work together to aid the auditor in understanding the assumptions, and determining which are significant to the estimate.

Furthermore, the note to paragraph .15 in the Proposal states that if the company has identified significant assumptions used in an accounting estimate, the auditor's identification of significant assumptions should also include those assumptions. Generally, management's processes and controls are designed to operate at a greater level of precision than the auditor's materiality and testing thresholds. Due to this difference, it is possible the auditor's conclusion as to which assumptions are significant could differ from management's. We are of the view that if the auditor is able to demonstrate that an assumption is not significant (based on the factors provided in paragraph .15), the auditor should not be required to identify the assumption as significant solely because management did. As noted in the Proposal, AS 2110, *Identifying and Assessing Risks of Material Misstatement*, establishes requirements regarding the process of identifying and assessing risks of material misstatement, including the likely sources of potential misstatements with a particular account or

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<sup>9</sup> See paragraph .10 of the Proposal.

<sup>10</sup> See paragraph .15 of the Proposal.

disclosure.<sup>11</sup> As such, a separate requirement incremental to existing risk assessment requirements for the auditor to assess assumptions management considers significant should not be required. Therefore, we recommend that the PCAOB remove this note from the Proposal or revise the note to read along the lines of: “Note: The auditor should consider the significant assumptions used in the accounting estimate identified by the company when assessing risk; however, based on the auditor’s assessment of the risks of material misstatement, the auditor’s identification of significant assumptions is not required to be the same as the company’s.”

Paragraph .18 would require, for critical accounting estimates, the auditor to “obtain an understanding of how management analyzed the sensitivity of its significant assumptions to change, based on other reasonably likely outcomes that would have a material effect. The auditor should take that understanding into account when evaluating the reasonableness of the significant assumptions and potential management bias.” This proposed requirement may place undue emphasis on this particular Management Discussion and Analysis of Financial Condition and Results of Operations (MD&A) disclosure. Therefore, we believe it would be more appropriate to align the requirement more closely with the auditor’s risk assessment (e.g., by requiring the auditor to obtain this understanding for estimates affected by significant estimation uncertainty).

### **III. Valuation of Investments Based on Investee Financial Condition or Operating Results**

Proposed Appendix A to Auditing Standard 1105, *Audit Evidence* (Proposed Appendix A to AS 1105) seems to provide requirements similar to situations that involve the auditor’s supervision of other auditors as it relates to the valuation of investments based on investee financial condition or other operation results. We note that the PCAOB is considering wider changes to the auditing standards relating to the supervision of audits involving other auditors. As part of that project, the PCAOB should align the requirements of both this Proposal and changes to auditing standards relating to the supervision of audits involving other auditors to achieve its objectives when finalized.

Proposed Appendix A to AS 1105 describes the auditor’s responsibilities for obtaining sufficient appropriate audit evidence in certain situations in which the valuation of an investment selected for testing is based on the investee’s financial condition or operating results. However, there is no discussion of the auditor obtaining an understanding of management’s process and controls over the recording of amounts related to its investment that are recorded in the consolidated financial statements, which is a responsibility of management. It would be helpful to include obtaining an understanding of management’s processes as a consideration in Appendix A to AS 1105.

The examples provided in Proposed Appendix A to AS 1105 for situations in which the valuation of an investment is based on the investee’s financial condition or operating results could expand the current requirements for auditors without benefitting audit quality. The second note to paragraph .A1 implies that an auditor may use the assessed risk of material misstatement to apply professional judgment in determining the persuasiveness of the evidence needed. However, paragraphs .A2 - .A5 provide specific procedures for the auditor to perform in evaluating audit evidence related to the valuation of the investee investment based on the investee’s financial condition or operating results regardless of assessed risk of material misstatement.

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<sup>11</sup> See paragraph .04 of the Proposal.

As a result, paragraphs .A2 - .A5 could be interpreted to imply the additional procedures would always need to be performed in order to increase the persuasiveness of the evidence gathered. Additional clarification by the Board on this matter would be helpful in demonstrating how an auditor would scale the procedures based on the level of risk.

Proposed Appendix A to AS 1105 would also require the auditor to obtain information about the procedures the investee's auditor performed and the results thereof or review the audit documentation of the investee's auditor.<sup>12</sup> It is our understanding that the investee's auditor may not be under any obligation to provide such information. For many noncontrolling investments, company management may not always have direct access to investee management to arrange for the company auditor to perform the proposed procedures, and in some cases the company may not be entitled to such information pursuant to the terms of the investment arrangement. We would encourage the Board to consider replacing paragraph .A4b with an additional explanation as to how the nature, timing, and extent of testing would vary if the investee's financial statements were used as part of the company's valuation process.

In addition, the Note to paragraph .A4 appears to provide an exception to this paragraph for audits of investment companies, but only if the auditor tests the "investment company's procedures for understanding the characteristics of underlying investments of the investee fund and assessing the investee fund's valuation process."<sup>13</sup> We believe it should be sufficient for the auditor to independently understand the characteristics of the underlying investments of the investee fund and assesses the investee fund's valuation process. Thus, the auditor should not have to test the investment company's process to be exempt from obtaining information about the audit of the investee or review audit documentation.

Proposed Appendix A to AS 1105 suggests that if the investee's financial statements were audited, the auditor should read available financial statements of the investee to obtain an understanding of whether the report of the investee's auditor indicates that the audit was performed under PCAOB standards and that the auditor expressed an unqualified opinion. There are often situations where the financial statements of investees are audited under other auditing standards, for example, those of the American Institute of CPAs or International Auditing and Assurance Standards Board (IAASB). The Proposal should not limit the auditor's ability to use audit reports issued in accordance with standards set by other bodies, but rather allow the auditor to evaluate the standards under which the audit was performed and the impact it would have on the audit approach. As currently written, without providing a framework for the auditor to use to evaluate other audit standards, the Proposal could be interpreted as an implied requirement for all investees to have audits performed in accordance with PCAOB standards, when there is no requirement for such an audit.

Auditing Standard 2410, *Related Parties* (AS 2410), establishes requirements regarding the auditor's evaluation of a company's identification of, accounting for, and disclosure of relationships and transactions between the company and its related parties. In applying AS 2410, the objective of the auditor is to obtain sufficient appropriate audit evidence to determine whether related parties and relationships and transactions with related parties have been properly identified, accounted for, and disclosed in the financial statements. Appendix A to AS 1105 would require the auditor to perform procedures to identify significant transactions

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<sup>12</sup> See paragraph .A4b in Proposed Appendix A to Auditing Standard 1105 in the Proposal.

<sup>13</sup> See note to .A4 on page A2-9 of the Proposal.

between the company and the investee and to evaluate the accounting for and disclosure of those transactions. For those investees considered to be related parties, we propose revising this requirement to link to AS 2410 to avoid confusion on what procedures would be performed as part of this requirement that are not already included in AS 2410.

Proposed Appendix A to AS 1105 states the auditor should, “with respect to subsequent events and transactions of the investee occurring after the date of the investee’s financial statements but before the date of the company’s auditor’s report, read available interim financial statements of the investee and other available information and make inquiries of the investee to identify subsequent events and transactions that could be material to the company’s financial statements.”<sup>14</sup> We believe the requirement would be difficult to operationalize, as often the investor company’s auditor does not have direct access to investee management. The proposed requirement to make inquiries of the investee should be a procedure to consider performing depending on the level of risk identified.

Proposed Appendix A to AS 1105 includes a requirement for the auditor to perform procedures over those factors other than the financial condition and operating results reported in the investee’s financial statements that impact the valuation of the company’s investment.<sup>15</sup> This requirement seems to contradict the principles in the risk assessment standards, as the auditor is required to perform procedures on such factors without regard to the risk of material misstatement associated with them, or the potential impact they may have on the valuation of the company’s investments. We believe the auditor should exercise professional judgment in evaluating the risk(s) of material misstatement associated with the factors reflected in the valuation of the company’s investment and perform procedures responsive to the identified risk(s).

Proposed Appendix A to AS 1105 would provide a scope exclusion for equity method investments if (1) the investor's equity in the underlying net assets and its share of the earnings or losses of the investee are recorded based on investee financial statements that are audited by an auditor other than the principal auditor and (2) the other auditor is supervised under Auditing Standard 1201, *Supervision of the Audit Engagement* (AS 1201), or the work and report of the other auditor are used under Auditing Standard 1205, *Part of the Audit Performed by Other Independent Auditors*.<sup>16</sup> This scope exclusion should also apply when the equity method investment is audited by the same auditor as the principal auditor and is supervised pursuant to AS 1201.

#### **IV. Audit Evidence**

##### *Third-Party Pricing Information*

Appendix A of the Proposal indicates that the auditor should assess the relationship the pricing service and/or broker dealer has with management, and whether they have the ability to directly or indirectly control or significantly influence the pricing service and/or broker dealer.<sup>17</sup> Third-party pricing services generally provide independent pricing information free of influence from any one issuer (e.g., the same price is released to all

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<sup>14</sup> See .A3b of the Proposal.

<sup>15</sup> See .A3d of the Proposal.

<sup>16</sup> See footnote 1 of Proposed Appendix A to AS 1105.

<sup>17</sup> See paragraphs .A4c and .A9a in Appendix A of the Proposal.

customers without bias), and we believe that this absence of management bias increases the relevance and reliability of the evidence. Paragraphs .A4c and .A9a should be updated to make it clear that when considering the relationship of the pricing service or broker dealer with the issuer, the auditor would consider the results of the procedures completed in accordance with AS 2410. Pricing information from parties not considered to be related parties would be more independent than pricing information from sources determined to be related parties.

Appendix A could be made more clear as to whether the requirements apply to each individual financial instrument (e.g., individual security basis by CUSIP number) selected for testing, or whether auditors are able to perform certain evaluations more broadly (e.g., in buckets) about the third-party's pricing practices and methodologies. Paragraphs .A5 –.A7 appear to assume that the auditor understands how each financial instrument in the portfolio is valued, including what the inputs were or what the 'similar' financial instruments used to value the financial instrument were. This information may not be available to auditors from the pricing service due to its proprietary nature. Instead of obtaining an understanding of how the fair value of each individual financial instrument was developed, auditors should be able to assess the estimation uncertainty of the financial instruments based on the asset class and other characteristics of the financial instrument. If auditors believe the financial instrument has lower estimation uncertainty, we believe that auditors should be allowed to understand and evaluate the methods and inputs used by pricing services at a group level (e.g., by asset class) rather than for each individual financial instrument. We recommend that the Board make it clear that the assessment of risk and level of estimation uncertainty can be considered when the auditor is applying the requirements in Appendix A.

Paragraph .A8 lists four conditions that must be met in order to be able to obtain "less information ...about the particular methods and inputs used by the individual pricing services." While this paragraph was likely intended to reduce the necessary effort of auditors to evaluate the methods used by pricing services if there are multiple pricing services pricing the same financial instrument, each of these conditions could require additional procedures to be performed by the auditor, perhaps making it impracticable for the auditor to utilize the benefits of this paragraph. We are of the view that if (i) the auditor assesses the financial instrument to have 'lower estimation uncertainty' (i.e., based on the asset class and other characteristics of the financial instrument), (ii) the auditor obtains multiple prices for the financial instrument, (iii) those pricing services routinely price that type of financial instrument, (iv) the prices obtained are reasonably consistent, and (v) the auditor has obtained an understanding of the pricing services' methodologies at an asset class level, the auditor would have obtained sufficient appropriate audit evidence with respect to the valuation of the financial instrument. We recommend that the paragraph be updated to reflect these considerations.

#### *Developing an Independent Expectation of the Estimate*

The Proposal states that "If the auditor's independent expectation consists of a range rather than a point estimate, the auditor should determine that the range is appropriate for identifying a misstatement of the accounting estimate and supported by sufficient appropriate audit evidence."<sup>18</sup> While this language better acknowledges the variability and imprecision that may be inherent within the range of possible outcomes, we remain concerned that the statement implies a level of precision within a range of estimates that may not be

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<sup>18</sup> See paragraph .25 of proposed AS 2501.

feasible and could possibly limit the auditor's ability to use an independent estimate in combination with one or more other approaches to evaluate the reasonableness of the accounting estimate.

There are a variety of accounting estimates with high estimation uncertainty where the auditor's execution of one or a combination of approaches, as described in the Proposal, may indicate a range of 'reasonable' estimates (e.g., certain insurance reserves, mortgage servicing rights), which could exceed the established materiality threshold. We recommend the Board include clarification in the Proposal that would indicate that a range of 'reasonable' estimates could exceed the established materiality threshold. For example, the following language could make this concept clearer: "While the range may serve to confirm higher estimation uncertainty, this should not preclude the auditor, after performing sufficient appropriate procedures, from concluding that management's accounting estimate is reasonable. If the auditor concludes that it is appropriate to develop a range, the auditor narrows the range, based on available audit evidence, until all outcomes within the range are considered reasonable."<sup>19</sup>

#### *Contradictory Evidence*

The auditor applies the requirements of extant Auditing Standard 1105, *Audit Evidence* (Extant AS 1105), for purposes of designing and performing audit procedures to obtain sufficient appropriate audit evidence. Extant AS 1105 states that "Audit evidence consists of both information that supports and corroborates management's assertions regarding the financial statements or internal control over financial reporting and information that contradicts such assertions."<sup>20</sup> In executing the audit, the auditor considers evidence obtained in other areas of the audit that may contradict evidence provided by the company to support an accounting estimate. This includes situations where the auditor has chosen to develop an independent expectation of an accounting estimate. Regardless of the nature of planned audit procedures, the auditor understands management's process for developing the accounting estimate and considers whether the auditor is aware of potentially contradictory audit evidence, either related to the estimate or from evidence obtained elsewhere in the audit. We recommend that the Board update the Proposal to include the requirements in paragraph .02 of Extant AS 1105. This would help clarify how an auditor should approach evaluating audit evidence obtained to determine if it corroborates or contradicts management's conclusions about the reasonableness of the accounting estimate.

## V. Other Matters

Amending the auditing standards may not address all challenges in these potentially complex areas, as they are only applicable to the auditors and not to the financial statement preparers. For instance, calls for additional transparency regarding accounting estimates, including fair value measurements, may be better addressed through corresponding changes to the financial reporting framework to enhance or expand required disclosures. Therefore, we believe a holistic approach that examines opportunities for improvement in the roles and responsibilities of all members of the financial reporting supply chain will best meet the needs of investors and other stakeholders, and we encourage regulators and standard-setters to consider the benefits to users of the financial statements of maintaining alignment. This approach will be even more

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<sup>19</sup> See section 3.6 of the CAQ's [Auditing Accounting Estimates and Fair Value Measurements: A Framework](#).

<sup>20</sup> See paragraph .02 of AS 1105.

important when the PCAOB's final auditing standard over the auditor's reporting model is effective, which will require auditors to disclose critical audit matters in the auditor's report.

The proposed amendment to paragraph .64 of Auditing Standard 2401, *Consideration of Fraud in a Financial Statement Audit*, eliminates the following sentence relating to performing a retrospective review: "The significant accounting estimates selected for testing should include those that are based on highly sensitive assumptions or and are otherwise significantly affected by judgments made by management." As a result, the paragraph now appears to require the auditor to perform a retrospective review for all accounting estimates. We believe the wording should be modified to allow the auditor to consider the inherent risk of the accounting estimate in determining whether to perform this procedure.

As noted in the Proposal, this Proposed Standard would replace Auditing Standard 2501, *Auditing Accounting Estimates* (AS 2501), as well as supersede Auditing Standard 2502, *Auditing Fair Value Measurements and Disclosures*, and Auditing Standard 2503, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities* (AS 2503).<sup>21</sup> As a result of the Proposed Standard replacing one standard and superseding two others, some guidance in the current standards is no longer included in the Proposed Standard. The Board should consider if there is any guidance being replaced or superseded that should be included in the Proposal. For example, there is guidance in AS 2503 related to auditing derivatives that should be included in the Proposed Standard.

## **VI. Application**

As the Board indicated in the Proposal, "accounting estimates are common in the financial statements of many emerging growth companies (EGCs). Therefore, investors in EGCs may benefit as much as, if not more than, investors in other types of issuers as a result of the proposed amendments."<sup>22</sup> The CAQ agrees with the Board's statement in the Proposal. Consistent with that view, the Proposal should be applicable to EGCs.

We are supportive of the Proposed Standard being applicable to the audits of brokers or dealers. The Board should consider if they should release guidance specific to auditors of brokers or dealers that would assist them with implementing the Proposal.

## **VII. Effective Date**

We recognize the Proposal, if approved, could represent a significant increase in efforts from smaller firms. In particular, the requirements in the Proposal will have a significant impact on planning and risk assessment procedures that will require the development of audit methodologies and training that will need to be in place before the start of the audit. In the text of the Proposal the Board recognizes that they have observed differences in the methodologies followed by larger and smaller firms when auditing fair value measurements.<sup>23</sup> The Board should consider this point as it determines the final effective date. The amount

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<sup>21</sup> See page i of the Proposal.

<sup>22</sup> See page 53 of the Proposal.

<sup>23</sup> See section titled "Current Audit Practices Regarding Accounting Estimates" on pages 10 and 11 of the Proposal.

of time a firm needs to prepare for the new standard may be different based upon the methodologies that firm follows today to audit accounting estimates, and some firms may need more time to prepare for implementation of the proposed changes.

Audit firms will need to develop and implement training and effective quality control processes to be in place at the beginning of the audit to support and facilitate the effective implementation. To help ensure smaller firms have sufficient time to prepare, we recommend that the standard be effective for audit periods ending two years after the SEC approves the final standard.

### VIII. Conclusion

The CAQ is supportive of the Board's development of a potential new standard related to auditing accounting estimates and fair value measurements, and commends the Board and its Staff for advancements made in this important area.

We encourage the PCAOB to continue to work closely with the IAASB as each body develops standards in this important area. The CAQ also submitted a comment letter in response to the IAASB's Proposed International Standard on Auditing (ISA) 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*, which the PCAOB may find informative.<sup>24</sup>

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The CAQ appreciates the opportunity to comment on the Proposal and would be pleased to discuss our comments or answer any questions that the Staff or the Board may have regarding the views expressed in this letter.

Sincerely,



Cynthia M. Fornelli  
Executive Director  
Center for Audit Quality

cc:

PCAOB

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

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<sup>24</sup> See the [CAQ's August 1, 2017 comment letter submitted to the IAASB](#).

SEC

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