



November 3, 2014

Office of the Secretary
Public Company Accounting Oversight Board
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Via Email to comments@pcaob.org

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Re: Staff Consultation Paper – Auditing Accounting Estimates and Fair Value Measurements

Dear Board Members and Staff:

Grant Thornton LLP appreciates the opportunity to comment on the Staff of the Office of the Chief Auditor (“staff”) of the Public Company Accounting Oversight Board’s (“PCAOB” or “Board”) Staff Consultation Paper – Auditing Accounting Estimates and Fair Value Measurements (“Consultation Paper”). We agree with the staff that the area of accounting estimates and fair value measurements within financial reporting frameworks has evolved over the past decade while the corresponding auditing standards have remained relatively unchanged. We are supportive of the staff’s efforts on this topic and commend the Board for the outreach activities performed thus far.

We see clear benefits to having one standard for accounting estimates and fair value measurements as discussed in the Consultation Paper; however, we strongly caution the staff to continue to bear in mind that many types of accounting estimates, with varying degrees of complexity and general risk would be subject to such a standard. Therefore, we believe a principles-based standard that does not prescribe a large number of specific requirements will be most beneficial to auditors and audit quality. We agree with the staff’s desire to align this area with the risk assessment standards and we continue to encourage the coordination and involvement of international and other US standard-setters in order to support consistency in global practice.

Finally, we believe the issue of high measurement uncertainty, while acknowledged as an issue, is not dealt with sufficiently in the Consultation Paper. We believe that a new standard needs to better address the auditor’s responsibilities and possible responses to high measurement uncertainty. For example, we note certain standard-setters emphasize the adequacy of company disclosures under a fair presentation framework as one element of addressing high measurement uncertainty. Along those lines, the PCAOB might consider circumstances where, without management disclosing what they view as the range of uncertainty and the support for the point estimate they chose, the transparency to the user could be compromised. We urge the PCAOB to consider further study and outreach in this area. We note that a wide-ranging number of views

have been advanced in recent years, for example the research paper Bob Herz cited in the recent SAG meeting (Columbia University American Assembly Report: *The Future of the Accounting Profession*, 2003) and *Extreme Estimation Uncertainty in Fair Value Estimates: Implications for Audit Assurance* (Christensen, Glover, Wood; published February 2012). We believe the profession and PCAOB can effectively address these issues, and we believe enhancements to audit standards in this area would provide the most significant benefit to users of the financial statements.

We respectfully submit the following comments to the staff's specific topics and questions contained in the Consultation Paper.

Consideration of need for change and alternative approaches

We generally agree with the staff's characterization of current audit practice and acknowledge that the profession is inconsistent with the application of the current standards to different estimates and valuations, but we are not convinced that this inconsistency is inappropriate, depending on the circumstances. However, we believe an approach that is overly prescriptive and detailed in its requirements that would be applied to auditing all accounting estimates and fair value measurements would pose difficulties and may result in an increase in costs without a corresponding increase in benefits. Accordingly, we believe further dialogue on the areas at issue would be helpful in developing a framework that provides flexibility to the auditor, with specific implementation guidance focused on the key issues identified by inspections staff and users of the financial statements. For example, the staff's questions on page 15 of the Consultation Paper seem to focus on fair value measurements and pricing sources, and while we agree that this specific area could benefit from additional audit guidance, we believe it's imperative to consider all manner of estimates and valuations when developing a potential new standard. We encourage the staff to continue to consider the root causes of its concerns and focus on how to address those specifically as opposed to requiring a prescriptive approach across all accounting estimates and fair value measurements.

Single standard approach

We believe a single standard approach would provide the most benefit to the auditing industry and alleviate confusion in practice as to which auditing standard should be applied. We also believe there is sufficient commonality with respect to accounting estimates and fair value measurements relative to the process of management's selection and use of assumptions and inputs to allow for one standard.

Given the wide variety of estimates that would fall under the proposed new standard, the ability for the auditor to use his/her judgment in determining the nature and extent of procedures to be performed on each accounting estimate or fair value measurement is imperative. The breadth of applicability should preclude adoption of detailed, one-size-fits-all performance requirements. If the proposed new standard were to be prescriptive with required procedures applicable to all estimates and fair value measurements, the total work effort necessary to comply with the new proposed auditing standard will not always align with the auditor's corresponding risk assessment, thus creating inefficiencies in the audit process with little or no improvement to quality. For example, the risks of misstatement associated with a Level 3 investment are often different and require more audit attention than those identified in a typical allowance for doubtful accounts

estimate. As such, the extent of procedures performed on the Level 3 investment should be commensurate with its level of risk, as determined by the auditor, in relation to the financial statements taken as a whole.

Therefore, we believe the staff should develop key principles in the proposed new standard and minimize the amount of prescriptive requirements. We believe a principles-based standard that includes enhanced application guidance to address specific areas (such as use of specialists) could enhance audit quality. Auditor judgment in determining the risks and the extent of procedures necessary to address those risks associated with each accounting estimate and fair value measurement should be a key principle in this standard-setting process.

We believe estimates and values with very high measurement uncertainty (equal to or greater than materiality) may call for auditors to consider alternative or additional audit procedures, and we would like the PCAOB to specifically explore the need for guidance in this common circumstance. For example, management's selection of a point value within the range of reasonably possible values may bear more focus when the range is very large.

Additionally, we encourage the staff to consider the current accounting standards and SEC rules with respect to management responsibilities and disclosures. Recent SEC and FASB efforts to address disclosure "overload" are important aspects of addressing opaque or disjointed disclosures, and hopefully those efforts will begin to address those issues. In some respects, the PCAOB's outreach on the auditor's reporting model could inform this project as it relates to the transparency of the audit work around estimates and fair values, particularly those with high measurement uncertainty.

Alignment with the risk assessment standards

We support the staff's efforts to align the proposed new standard with the current risk assessment standards. Further, we believe the level of understanding obtained about the processes used to develop estimates should be scalable based on the intended testing approach. Accordingly, we believe it would be helpful to auditors and other interested parties to better understand the PCAOB's views on the connection to risk assessment. Does the staff believe auditors are assessing risks as too low or are auditors identifying the risks appropriately but the audit response is not commensurate with the assessed level of risk? We suggest additional dialogue to further clarify the staff's views and the basis for those views as the staff continue this project.

With respect to circumstances where the company uses information obtained from a third party, we encourage the staff to exercise caution in developing requirements in this area. The auditor is not auditing the third party. There may be instances where the auditor may deem it necessary to investigate further into the basis and support for third-party methods and assumptions in order to better understand the process or to validate that the data provided by management was appropriately conveyed to the third party. Likewise, circumstances may be such that extensive work on the third-party information is deemed unnecessary given the risks associated with the audit area as well as those associated with that third party. We refer the staff to the more detailed discussion of third parties included later in this letter.

We generally agree with the potential amendment to AS 12 referenced in Question 14 of the Consultation Paper but are concerned as to how the staff views this would apply to a portfolio (i.e., would each CUSIP need to be vetted individually?). We believe this may be an example of where being too prescriptive in the proposed new standard could create operational issues for auditors when applying the requirements to all accounting estimates and fair value measurements. Additionally, it may be difficult concluding that the auditor is in a better position to determine the appropriate amount for a given accounting estimate or fair value measurement than management. It would be helpful to acknowledge and consider this principle in developing a proposed standard.

With respect to Question 15 of the Consultation Paper, we believe the current guidance and requirements with regard to identifying significant risks is sufficient, and further guidance in this area would be redundant. We believe additional guidance would be better served in the area of measurement uncertainty and how that impacts the auditor's risk assessment and related response, particularly for those estimates where the potential acceptable range is greater than materiality. In some circumstances, no amount of audit procedures can reduce the measurement uncertainty inherent within some accounting estimates and fair value measurements. However, the auditor is required to assess whether management's recorded value and related disclosures achieve the goals of a fair presentation (under US GAAP) of that estimate or measurement.

Further, we are concerned with the potential amendment to AS 13 discussed in Question 18 of the Consultation Paper. We believe it may have the unintended consequence of driving the auditor to assess the minimum requirements of the applicable financial reporting framework, as opposed to focusing the auditor on management's responsibility for disclosing sufficient information so that an investor may gain a full understanding of the uncertainty of the estimate. We refer to paragraph four of AU section 411, *The Meaning of Presents Fairly in Conformity with Generally Accepted Accounting Principles* ("AU 411"), which states that "the auditor's opinion that financial statements present fairly...should be based on his/her judgment as to whether...(c) the financial statements, including the related notes, are informative of matters that may affect their use, understanding and interpretation." Paragraph three of AU 411 states that "the independent auditor's judgment concerning the "fairness"...should be applied within the framework of generally accepted accounting principles. Without that framework, the auditor would have no uniform standard for judging the presentation..." Applying the concepts within these two paragraphs has proven difficult when applied to fair value measurements with high measurement uncertainty given the perceived disconnect between what management is required to disclose and what a user would find useful within those disclosures. How then should the auditor determine fairness in presentation under the applicable financial reporting framework when that framework does not require disclosures that would truly inform a user of the financial statements such that the estimate or value can be understood, interpreted and used? Does the auditor have the responsibility to require disclosures not specifically called for by the applicable financial reporting framework when, in the auditor's judgment, they are needed by the user and required for a fair presentation? We strongly encourage the PCAOB to engage accounting standard-setters and the SEC in developing potential solutions that are aligned with the goal of increasing user transparency into estimates and fair value measurements that are subject to high measurement uncertainty.

With respect to providing specific requirements for testing internal controls over accounting estimates (Question 20 of the Consultation Paper), we believe this would only be helpful if the staff believe there are underlying issues in this area that need to be addressed through standard-setting. We believe the auditor's ability to use judgment in assessing and responding to risks associated with accounting estimates is an important principle to be preserved in this project.

Although we believe current guidance is sufficient in identifying significant risks associated with accounting estimates, we believe more specific guidance on addressing those risks would provide needed clarity to auditors. Considerations such as those included in the International Standard on Auditing 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures* ("ISA 540") may be an appropriate starting point in developing further guidance for auditors in this area. As we have noted in our general comment, enhancing the standards in this area is critical to improving the auditor's response to significant risks.

Substantive procedures

We encourage the staff to retain the current methods for substantively testing accounting estimates. Additional guidance could potentially be useful with regard to the selection of testing approaches, but we encourage this be provided as guidance and not prescriptive requirements. As we've noted with risk assessment, it's important that the auditor retain the ability to exercise judgment in scoping this testing as well as in developing audit procedures for testing completeness and accuracy of data used. We believe the staff should consider providing additional guidance where a combination of approaches are used in obtaining sufficient appropriate audit evidence of an accounting estimate as this situation arises fairly frequently particularly where auditor specialists are involved.

The proposed new standard could also negatively impact engagement economics particularly for medium and small firms, as it may be difficult for some firms to operationalize prescriptive requirements. We believe operational issues may be avoided or alleviated by taking a principles-based approach.

Testing management's process

With respect to the continued use of paragraph 39 of AU 328, we remind the staff that this paragraph is focused on testing data produced by the company. Applying footnote 2 of AU 328 in a prescriptive manner to all data used in the development of the estimate would be highly problematic. We believe there needs to be consideration given as to the sources of data, such as whether it's generated by the company or by a third-party specialist engaged by management or by an independent third party source. This would allow the auditor to judge the relevance and reliability of that data based on factors, such as prior experience and reputation of the third party, and to design the appropriate procedures around the relative risks of completeness and accuracy of that data accordingly.

We also believe requiring the auditor to evaluate whether the company's methods are accepted within the company's industry is not workable when considering accounting estimates that currently fall under the requirements of AU 342. We believe the cost associated with executing such an evaluation on all accounting estimates would outweigh the benefit and would ultimately

not contribute to enhancing audit quality. For example, what would be the auditor's responsibility to seek out and know all methods accepted in a given industry? Also, how would this impact evolution and improvement to measurement methods? We acknowledge that industry may be relevant, and it's possible other criteria may be useful, but we don't believe the proposed new standard should prescribe evaluation of specific criteria. Rather, it should allow for the auditor to consider relevant criteria based on his/her judgment and experience. We also encourage the staff to reconsider the proposed requirements referred to in Question 26 of the Consultation Paper and evaluate whether some of these points are better positioned as management's responsibilities as opposed to the auditor's.

In regards to Questions 28 and 29, we have difficulty identifying circumstances where the auditor would identify a significant assumption that management did not, so a corresponding requirement for doing that doesn't appear operational. Rather, we recommend the staff consider a requirement to evaluate whether the data used by management is relevant to the estimate. Similarly, we are concerned that requiring the auditor to conclude on each significant assumption made by management (as suggested by the procedures referenced in Question 30 of the Consultation Paper) could result in an increase in audit procedures without a meaningful focus on the risks. For example, we note that in practice "significant" assumptions are not all equally important and they are not always entirely independent of each other, causing the auditor to evaluate the combined assumptions. Mandating conclusions on each significant assumption would be counter to the intended focus on the risk assessment standards and may result in over-auditing. While an auditor currently considers key assumptions in testing an estimate, the ultimate conclusion is on the estimate's recorded value in the context of the financial statements taken as a whole. We strongly encourage the staff to reevaluate their initial concept. The notion of evaluating the consistency of every item listed for every significant assumption is not practical and would not provide a meaningful increase in audit quality.

Developing an independent estimate

With respect to Question 35 of the Consultation Paper, there can be challenges with developing sufficiently precise independent ranges; as described in our opening comments on material measurement uncertainty, we believe further study of this area to address circumstances where the acceptance range is greater than materiality is critical in providing appropriate transparency to users of the financial statements.

Evaluating subsequent events

We believe this approach continues to be relevant and beneficial to auditors; therefore, we are supportive of retaining this option for testing. We have no significant concerns with regard to the staff's proposal in this area but continue to caution against being overly prescriptive in the proposed new standard. For example, guidance related to the level of audit evidence obtained should be commensurate with the risk of material misstatement associated with the estimate in relation to the financial statements taken as a whole.

Use of third parties

We are supportive of the staff's recognition that differences may exist between specialists and third-party pricing sources particularly in consideration of the information/evidence provided by

such sources, and we encourage the staff to acknowledge and account for this in the new proposed standard. Generally, we believe that the capacity in which services are used within the audit creates the needed distinctions between different specialists and third-party pricing sources. In considering risk assessment, the risks associated with these third parties seem to arise from a continuum of various factors, including but not limited to:

- Whether the measurement is done by an independent expert
- The nature of the relationship between the expert and the company relative to the information being provided by the expert
- The level of measurement uncertainty
- Whether measurement is performed by a qualified expert with an established track record
- Reliability of the input data

We believe the risks associated with third-party pricing sources in many circumstances are of a lesser magnitude than those typically associated with specialists engaged by management. Information provided by third-party pricing sources is for the most part generally available and not produced for the benefit of a single company whereas a specialist is typically engaged by a company to determine or assist in determining a specific estimate in that company's financial statements. Therefore, one could perceive that there is less risk in a third-party pricing source's information being materially misstated given that it is widely used by preparers and auditors. The auditor should be able to scale the rigor of audit testing over this information based on an appropriate risk assessment, which we believe may be of a lesser magnitude than audit procedures associated with information provided by management-engaged specialists that is more specific to the entity.

To explore this further, we would note that for most pricing, no company-specific information is used or relied upon by the third-party pricing source. Auditors would still be able to gain an understanding of the processes used by the third-party pricing source but testing of that process could reasonably be limited based on the lower risk. This would avoid unnecessary issues and potential scope limitations given the proprietary nature of the underlying models used by pricing sources.

We believe the auditor should be able to evaluate the information provided by any third-party specialist, including pricing sources, in the context of the subject matter and the reputation of the third party and design procedures from there as opposed to testing relevance and reliability of all third-party information or assumptions to the level which those of management are subjected to.

With regard to Questions 38 and 41 of the Consultation Paper, the potential requirements could address centralized testing procedures; the potential issue for smaller firms would be driven by perceived expectations of the Board based on other aspects of the Consultation Paper, such as testing third-party data in every circumstance or whether judgment can be applied in determining the need to test in more detail. We believe that the staff should specifically allow for centralized testing and assessment of reliability of the information provided by the third party in order to lessen the administrative burden on the third parties that could be caused by not allowing such an approach. We do not believe this approach would be detrimental to audit quality.

We very much agree that there may be circumstances when a third-party source should be treated differently, as discussed in Question 39 of the Consultation Paper; we believe the requirements and related guidance in assessing these circumstances could align directionally with the thinking around when a third party is deemed a specialist (versus, for example, a pricing source).

We would be pleased to discuss our comments with you. If you have any questions, please contact Trent Gazzaway, National Managing Partner of Professional Standards, at (312) 602-8034 or Trent.Gazzaway@us.gt.com.

Sincerely,

