



CENTER FOR CAPITAL MARKETS  
COMPETITIVENESS

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August 30, 2017

Ms. Phoebe W. Brown  
Secretary  
Public Company Accounting Oversight Board  
1666 K Street, N.W.  
Washington, D.C. 20006-2803

**Re: PCAOB *Proposed Auditing Standard–Auditing Accounting Estimates Including Fair Value Measurements and Proposed Amendments to PCAOB Auditing Standards* (PCAOB Release No. 2017-002, June 1, 2017) (PCAOB Rulemaking Docket Matter No. 043)**

Dear Ms. Brown:

The U. S. Chamber of Commerce (the “Chamber”<sup>1</sup>) created the Center for Capital Markets Competitiveness (“CCMC”) to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy. CCMC believes that businesses must have a strong system of internal controls and recognizes the vital role external audits play in capital formation.

CCMC supports efforts to improve audit effectiveness and appreciates the opportunity to comment on the Public Company Accounting Oversight Board (“PCAOB”) Exposure Draft on *Proposed Auditing Standard–Auditing Accounting Estimates Including Fair Value Measurements and Proposed Amendments to PCAOB Auditing Standards* (PCAOB Release No. 2017-002, June 1, 2017; PCAOB Rulemaking Docket Matter No. 043) (the “Proposal”).

The Proposal was preceded by a PCAOB Staff Consultation Paper on *Auditing Accounting Estimates and Fair Values* issued in August 2014 (the “Staff Consultation”).

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<sup>1</sup> The Chamber is the world’s largest federation of businesses and associations, representing the interests of more than three million U.S. businesses and professional organizations of every size and in every economic sector. These members are both users and preparers of financial information.

CCMC was a signatory on a comment letter on this Staff Consultation submitted by the Financial Instruments Reporting and Convergence Alliance (“FIRCA”).<sup>2</sup> Because concerns expressed in that letter remain in the Proposal, the FIRCA letter is included as an attachment.

The Proposal would replace or supersede three PCAOB auditing standards (AS 2501 on *Auditing Accounting Estimates*, AS 2502 on *Auditing Fair Value Measurements and Disclosures*, and AS 2503 on *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*) with one auditing standard on auditing accounting estimates that would encompass auditing fair value measures, derivatives and hedging. We have concerns about this approach as well as specifics in the Proposal.

### **1. Overly Broad Approach**

CCMC would like to reinforce concerns expressed by FIRCA about the PCAOB’s approach to condensing three extant auditing standards into one standard on auditing accounting estimates given the heterogeneous nature of these activities. For example, measuring fair values and accounting for derivatives and hedging are all very different functions, and the Proposal does not make a compelling case as to the benefits provided to audit quality by creating one standard for auditing all of these activities.

We also note that the Proposal would eliminate PCAOB guidance in AS 2503 for auditing derivatives and hedging activities. We understand that much of this guidance continues to be useful for auditors and question the wisdom of eliminating all of it.

Further, it is not clear that the Proposal adequately considers the implications of recent developments in generally accepted accounting principles (“GAAP”) by the Financial Accounting Standards Board (“FASB”) and International Accounting Standards Board (“IASB”) related to accounting estimates, fair values, derivatives and hedging. For example, companies are in the process, or soon will be, of implementing new GAAP requirements for revenue recognition and the determination of credit losses that can involve new and significant estimates. FASB has also recently finalized new guidance to simplify hedge accounting. There is no indication that the PCAOB has sought to identify and address any issues that have or will likely emerge with auditing accounting estimates under these new standards.

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<sup>2</sup> See the November 3, 2014 letter from FIRCA to the Honorable James Doty on PCAOB Staff Consultation Paper on *Auditing Accounting Estimates and Fair Value Measurements*.

Also, there is no indication that the PCAOB engaged in field-testing, which would also help to determine whether the Proposal is adequate for auditing under new GAAP. CCMC strongly encourages the PCAOB to field-test the Proposal before finalizing any new standard(s) on auditing accounting estimates, fair values, derivatives and hedging. Field-testing should have been used in the development of the Proposal as a means to determine problems, unforeseen consequences, and flaws.

While CCMC generally supports the proposal's principles-based approach, we are concerned about the implications of the PCAOB inspection process given that the Proposal condenses three current auditing standards into one overarching standard. Our particular concern is that the PCAOB inspection process will result in de facto standard-setting down the road. It is essential that the PCAOB have in place mechanisms to ensure this does not occur.

In the earlier FIRCA letter it was strongly recommended that the PCAOB establish a Business Advisory Group. Such a group would help the PCAOB adequately recognize and appreciate financial reporting structures to convey decision useful information to investors and businesses—and issues around auditing the financial reporting and systems of internal control over financial reporting that support it—in the process of developing auditing standards and conducting PCAOB inspections.

## **2. Specific Concerns with the Proposal**

CCMC also has concerns about the objective of auditing accounting estimates (including fair value measurements, derivatives and hedging) as articulated in the Proposal. Indeed the FIRCA letter stated that there was a failure to articulate a need in moving forward on this issue. The current PCAOB standard “provides guidance to auditors on obtaining and evaluating sufficient appropriate evidential matter to support significant accounting estimates in an audit of the financial statements” and recognizes that the “auditor is responsible for evaluating the reasonableness of accounting estimates made by management in the context of the financial statements taken as a whole.”<sup>3</sup> On the other hand, the Proposal states:

*The objective of the auditor is to obtain sufficient appropriate audit evidence to determine whether accounting estimates are reasonable in the circumstances, have been accounted for and*

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<sup>3</sup> See AS 2501.01 and 2501.04, respectively.

*disclosed in conformity with the applicable financial reporting framework, **and** are free from bias that results in material misstatement (emphasis added).*<sup>4</sup>

We have several issues with this approach. First, the determination of the reasonableness of accounting estimates is no longer articulated in the context of the financial statements taken as a whole. Second, the use of the term “and” appears to create three separate objectives—one of which is a determination that the estimates are free from bias that results in material misstatement. In regards to this objective, a subsequent section of the proposed standard on evaluating audit results instructs the auditor to evaluate bias in accounting estimates, which includes evaluating bias in estimates individually and in aggregate and whether bias results from the cumulative effect of changes in estimates.<sup>5</sup> The Proposal provides no other guidance specific to helping the auditor determine whether accounting estimates are free from bias.

We understand that including an objective on bias is intended to emphasize the need for auditors to exercise professional skepticism as part of the audit process. We appreciate the importance of auditors doing so. However, we question the need for a specific objective on determining bias in accounting estimates (including fair values, derivatives and hedging) to demonstrate that the auditor has exercised professional skepticism.

Essentially, it appears that the Proposal establishes a new performance obligation for auditors in regards to management bias that is separate and distinct from the auditor’s responsibility to express an opinion on whether the financial statements present fairly, in all material respects, an entity’s financial position, results of operations, and cash flows in conformity with GAAP. Any such new performance obligation for auditors would likewise be subject to PCAOB inspections and have consequences for companies.

We strongly urge the PCAOB to focus on providing guidance for auditors to obtain sufficient appropriate audit evidence to determine whether accounting estimates give rise to material misstatements in the context of the GAAP financial statements taken as a whole—and not create any separate and distinct obligation for auditors to also determine whether estimates are somehow free from bias that results in material misstatement.

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<sup>4</sup> See the Proposal, page A1-1.

<sup>5</sup> See the Proposal, pages A1-12 and A1-13.

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Finally, we note that the proposed standard includes guidance for auditors on using pricing information from pricing services and directs the auditor to consider other PCAOB auditing standards on using the work of a company specialist. However, the Proposal does not define or delineate the difference between pricing services and specialists. The PCAOB has received input that such delineation would be useful and we recommend doing so.<sup>6</sup>

Thank you for your consideration of these comments and we stand ready to discuss them with you further.

Sincerely,

A handwritten signature in black ink, appearing to read 'T. Quaadman', with a long, sweeping horizontal stroke extending to the right.

Tom Quaadman

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<sup>6</sup> For example, see the letter dated November 10, 2014 from the American Bankers Association to the PCAOB on the Staff Consultation Paper – *Auditing Accounting Estimates and Fair Value Measurements*.