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

PCAOB Rulemaking Docket Matter No. 043
Proposed Auditing Standard - *Auditing Accounting Estimates, Including Fair Value Measurements* and Proposed Amendments to PCAOB Auditing Standards

Dear Madam Secretary:

KPMG LLP is pleased to submit comments on the Public Company Accounting Oversight Board's (the PCAOB or the Board) Proposed Auditing Standard - *Auditing Accounting Estimates, Including Fair Value Measurements and Proposed Amendments to PCAOB Auditing Standards* (the Proposal or the Proposed Standard). We welcome the opportunity to work with the Board, PCAOB staff (the Staff), and other stakeholders to improve audit quality through enhanced auditing standards.

We agree that the Proposed Standard will result in the PCAOB auditing standards being strengthened in the following respects:

I. We are supportive of the single standard approach for auditing accounting estimates, including fair value measurements, that would supersede certain existing auditing standards referred to in the Proposal, including AS 2501, *Auditing Accounting Estimates* (AS 2501), AS 2502, *Auditing Fair Value Measurements and Disclosures* (AS 2502), and AS 2503, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities* (AS 2503, and collectively the Existing Standards), while retaining key requirements in a comprehensive standard. We believe that the process management uses to prepare accounting estimates, including fair value measurements, has common attributes that enable the PCAOB to meaningfully address auditing of estimates under a single standard. We believe that the Proposal as written is scalable to the applicable financial reporting framework, including both the revenue recognition and impairment of financial instruments accounting standards.

II. We believe that there is great benefit when the risk assessment standards are integrated into other auditing standards, and are supportive of the proposed amendments to other PCAOB auditing standards as a result of this Proposal.

III. We agree that improvements in the clarity and specificity of auditor requirements are presented in the Proposal. For certain areas, like testing the mathematical accuracy of the company's estimate and testing data used, we have included specific comments regarding our views on additional opportunities for further improvement.

IV. The Proposal demonstrates the PCAOB's understanding of, and takes into account the prevalent use of, pricing services by companies and auditors for the fair value of financial instruments, and how these services have evolved which affects the risk of material misstatement. Because we believe there is great benefit in the centralization of accumulating and evaluating audit evidence (e.g., investment pricing), we believe the Proposed Standard would be enhanced by providing guidance as to how individual engagement teams consider such evidence.

V. With regard to how auditors should address management bias, while reinforcing the need for professional skepticism, we believe that without a uniform judgment framework against which auditor skepticism can be evaluated, the Board's intent may be difficult to achieve. For example, the third Note to paragraph .05 of the Proposed Standard states that responses to the risks of material misstatement involve application of professional skepticism in gathering and evaluating audit evidence. Additional guidance as to what evidence is specifically expected beyond determining that it is persuasive to the identified risks and meets the criteria for relevance and reliability of audit evidence would be helpful.

We also acknowledge the Board's consideration and alignment with the existing ISA 540, *Auditing Accounting Estimates*. Reasonable convergence among auditing standards issued by other standard setters helps to enhance audit quality and comparability across the globe.

For the Board's consideration, we offer the comments below for further enhancement and clarification to the Proposal. When our comment is responsive to a specific question in the Proposal, we have indicated as such by **(Q#)** at the beginning of the paragraph.

Comments on the Proposed Standard

Objective

(Q17) As stated in the Proposal, accounting estimates by their nature have subjective assumptions and measurement uncertainty making them susceptible to management bias. We are concerned that the objective in paragraph .03 and the conclusion expected by paragraph .09 are not operational because the requirement for the auditor to obtain sufficient appropriate audit evidence to determine that accounting estimates are “free from bias” goes beyond providing reasonable assurance. While the proposed wording is similar to AS 2810.24 in its use of “free of material misstatement,” we recommend that the Board consider language such as that which is included in AS 2810.27 and AS 2501.04 to acknowledge that bias may exist, and to provide guidance on the auditor’s responsibility and steps to evaluate the extent of bias in determining whether a material misstatement exists.

Responding to the Risks of Material Misstatement

(Q19) We appreciate the Board’s retention of the three substantive approaches to testing and its decision to not require auditors to develop an independent expectation or limit the auditor’s selection of an approach when responding to the risks of material misstatement. While the Proposed Standard provides greater clarity as to the required audit response for each testing approach, it is unclear as to how the auditor would apply a combination of approaches. Paragraphs .07a-c of the Proposed Standard refer to more detailed requirement paragraphs for each testing approach which implies that the requirements in the respective referenced paragraphs would be applicable. Without additional guidance, applying a combination of approaches may result in auditors performing all requirements in the Proposed Standard, not just those necessary to obtain sufficient appropriate audit evidence.

We believe that auditors often combine testing management’s process with independently developing components of an estimate or independently testing certain assumptions, and therefore the approaches should not be mutually exclusive. Instead, when applying a combined approach, the focus should be on determining whether sufficient appropriate audit evidence has been obtained in response to the assessed risk, and not on compliance with a planned substantive testing approach. For this reason, the Board should clarify whether documentation of a specific testing approach, including any changes that are not related to a change in risk assessment, is expected.

When events or transactions relevant to estimates occur after the measurement date, the estimation uncertainty may be effectively eliminated, which affects risk assessment and the audit response related to valuation. We suggest the Board clarify the extent of additional procedures required, if any, when such events are considered and tested.

The Note to paragraph .07 appears to be from AS 2501, edited to remove reference to audit requirements in integrated audits. Because understanding management’s process is a required element of risk assessment, we are concerned that the Proposal language may lead auditors to test management’s process substantively, regardless of whether another approach will provide the same or more persuasive audit evidence. We also suggest more guidance be provided about how an auditor’s understanding of management’s process affects the auditor’s planned response to assessed risk in accordance with AS 2301, *The Auditor’s Responses to the Risks of Material Misstatement* (AS 2301). For example, the use of auditor data analytic techniques applied to large amounts of data (e.g., pricing data for investment securities) may make an independent estimate more effective, regardless of the sufficiency of management's process.

In addition, the inclusion of the phrase "and the results of tests of relevant controls" to that Note may be read to mean that relevant controls are expected to be tested in all audits. To better link to the requirements of AS 2301, we suggest adding "when applicable" after "controls" or a footnote reference to relevant requirements in AS 2301.

Use of Data Analytic Techniques

(Q4) The Proposed Standard is silent as to the use of data analytic techniques, which when considered with the specificity of the requirements of each testing approach, might suggest to auditors that substantive tests of detail are most appropriate, regardless of whether a significant or fraud risk exists. We believe that appropriately designed data analytic techniques may provide sufficient appropriate audit evidence, including for estimates, provided the completeness and accuracy of the data is tested. Consider the following examples of data analytic techniques that may be used to obtain sufficient appropriate audit evidence for relevant assertions related to estimates:

- Use of a data analytic technique to review plan data in a defined benefit plan frozen to new entrants in a stable interest rate environment. We believe it would be appropriate to consider evidence obtained in prior audits regarding the census data, and the development of key assumptions, and to use data analytics to extend the audit conclusion without re-performing all the audit procedures required to test management's original process. Likely, management's process is less robust in this fact pattern than would be expected if there were, say, a settlement of the obligation.

- Use of a data analytic technique to identify circumstances where management's estimate of the fair value of financial instruments, which is from a source determined to be relevant and reliable, is outside of an audit range developed from other pricing sources.

- Use of a data analytic technique to evaluate the reliability of prices from multiple sources.

- Use of a data analytic technique to compare data trends in estimates that rely on historical data, for example, loans acquired under deteriorated credit conditions accounted for under ASC 310-30.

Testing Approach for Fair Value of Derivatives and Securities

In practice, we believe auditors most often obtain audit evidence for estimates by testing management's process and that developing an independent expectation of an estimate may generally be necessary when sufficient appropriate audit evidence cannot be obtained from testing management's process alone. A notable common exception to this is when testing the value of derivatives and securities.

In applying AS 2503, some auditors independently obtain prices from sources that are different than management; others obtain prices irrespective of management's source. With regard to testing fair value:

- We recommend that the Board bring into the Proposed Standard the content from footnote 47 of Appendix 3, which explains that other requirements may restrict the auditor from using the same pricing source as management. Specifically, *Codification of Financial Reporting Policies Section 404.03, Accounting, Valuation and Disclosure of Investment Securities*, imposes a requirement on auditors of registered investment companies to examine the fund's valuation policies and procedures for compliance with generally accepted accounting policies and to verify all quotations used by the company at the balance sheet date and, in the case of securities carried at fair value as determined by the board of directors in good faith, "(to) review all information considered by the board or by analysts reporting to it." Discussion between the PCAOB and the SEC and further clarification about sufficient and appropriate audit procedures for evaluated prices, which are among the securities carried at fair value as determined by the board of directors in good faith, would be helpful to drive consistent application, in particular when the board of directors of a registered investment company choses to use a pricing service.

- Page A3-34 to the Proposal makes clear the auditor (excluding auditors of registered investment companies, due to SEC requirements previously discussed) may use management's source, provided there is appropriate evidence as to relevance and reliability of the source. We think it would be helpful to clarify this point within the Proposed Standard because, for many auditors, it will be a change in practice.

Testing the Company's Process Used to Develop the Accounting Estimate

Paragraph .09 of the Proposed Standard states that "Testing the company's process involves performing procedures to test and evaluate the methods, data, and significant assumptions…" We believe that this description of what testing the company's process entails is not clear because "test" is only used again in paragraph .12 with regard to testing data.

We believe the Proposed Standard would further enhance audit quality if there was greater clarity as to what is meant by "data" and "assumptions," as the requirements to be applied differ for the two. Assumptions are often judgmental and subject to management's bias. We consider data to be the aggregation of factual transactions (e.g., historic charge-offs or census data) or fact (e.g., benchmark interest rates) that can be objectively verified.

With regard to paragraph .20 of the Proposed Standard, we suggest providing additional guidance or criteria against which to evaluate whether the company has used third-party pricing information "appropriately" when assessing whether the information provides sufficient appropriate audit evidence.

Evaluating the Company's Method Used to Develop an Accounting Estimate

(Q20 and Q41) While we acknowledge that paragraph .10b is consistent with paragraph .15 of AS 2502, the requirement to evaluate whether the methods used are "appropriate for the nature of the related account or disclosure and the business, industry, and environment in which the company operates" may be somewhat redundant, as these considerations would be included in the assessment that the estimate was computed in accordance with the requirements of the financial reporting framework. Moreover, because the company's selection of accounting principles appropriate for the business, industry, and environment is addressed in AS 2110, *Identifying and Assessing Risks of Material Misstatement* (AS 2110), we believe this language may no longer be needed. We recommend that paragraph .10 be simplified as follows:

> The auditor should evaluate whether the methods used by the company[9] to develop the accounting estimates are in conformity with the requirements of the applicable financial reporting framework.
>
> Note: Evaluating whether the methods are in conformity with the requirements of the applicable financial reporting framework includes the selection from alternative methods that are appropriate for the entity, and evaluating whether the data and significant assumptions are appropriately applied.

(Q20) *Testing mathematical accuracy:* When evaluating the company's methods, we suggest that the Proposed Standard retain the requirement from AS 2501.11i to "test the calculations used by management to translate the assumptions and key factors into the accounting estimate." We believe obtaining evidence of the mathematical accuracy of the calculations is an essential element of concluding on the reasonableness of the estimate.

(Q21 and Q22) *Testing Data Used*

Completeness and accuracy of data used: We believe the Proposed Standard could benefit from a performance requirement for the auditor to evaluate whether all of the relevant data used in developing the estimate is accurate and complete, similar to the existing requirement with respect to fair value measurements included in the second sentence of AS 2502.39. Paragraphs .12 and .13 of the Proposed Standard refer to existing requirements in AS 1105.10 (Using Information Produced by the Company) and AS 1105.07-.09 (Relevance and Reliability), respectively, which are the sufficiency and appropriateness considerations applicable to all of the evidence obtained by the auditor from audit procedures or other sources. However, we do not believe that the considerations included in these paragraphs of

AS 1105, *Audit Evidence* (AS 1105), are themselves requirements to perform audit procedures that address risks of material misstatement as required by AS 2301. Therefore, we believe that a clear performance requirement such as “The auditor should evaluate whether the data used in the estimate is accurate and complete” should be included in place of paragraphs .12 and .13 of the Proposed Standard in order to articulate the auditor’s AS 2301 response that is expected with respect to data used in developing the estimate.

To further enhance paragraph .14 of the Proposed Standard for the auditor’s evaluation of management’s use of the data in the measurement, we also recommend that the guidance on evaluating management’s use of the data from pages A3-12 and A3-13 be included in the Proposed Standard.

Testing relevant data used: Paragraph .15 of the Proposed Standard requires the auditor to identify all significant assumptions, however there is not a similar requirement to identify all significant data elements in an estimate. Both the Existing Standards and the Proposed Standard are silent as to whether the data to be tested refers to all the data used or may be limited to the significant or relevant “inputs.” We recommend the Board consider clarifying the extent of data necessary to test.

(Q23) *Identification and Evaluation of Significant Assumptions*

We are concerned that the definition of significant assumptions in paragraph .15 may be too broad because it refers to assumptions that are “important” to the recognition or measurement of accounting estimates. The factors to consider in paragraph .15a-e do provide some context for what is considered “important,” but the factors could possibly be further enhanced by including the concept in AS 2502.33 regarding those that could materially affect the estimate.

Requirements of applicable accounting framework: Page A3-21 of the Proposal indicates that by taking into account the requirements of the financial reporting framework, the auditor might identify additional considerations to the estimate that the company did not take into account. Page A3-15 indicates that the Proposed Standard “does not require the auditor to identify assumptions beyond those used by management (including those implicit in a particular method or estimate).” These two statements appear to be contradictory, and also not consistent with paragraph .15 of the Proposed Standard. While this wording is not used in the Proposed Standard, the Board may wish to clarify its expectations of auditors to identify when management has not considered the need for a specific assumption to correctly apply the applicable accounting framework (as opposed to searching out all reasonable alternatives to assumptions selected).

In addition, the omission of such requirement to identify assumptions beyond what management identified may be inconsistent with the requirements of other PCAOB auditing standards. For example, AS 2110 notes that the auditor should evaluate whether the company's selection and application of accounting principles are appropriate for its business and consistent with the applicable financial reporting framework, etc. That standard also notes that the auditor should develop an expectation about the disclosures that are necessary, to verify that the company's disclosures are complete. In addition, AS 2110.38 notes that in performing walkthroughs and asking probing questions, the auditor will gain an understanding of when a control is missing or not designed effectively. In applying this control guidance to the estimate process, we believe an auditor is responsible for understanding the risk points in the estimate (and the underlying assumptions and data) and therefore would be responsible for evaluating the significance of assumptions and data not identified by management.

The first Note to paragraph .16 of the Proposed Standard requires the auditor to have a reasonable basis for the expectation when assessing reasonableness of an assumption by developing an expectation of management's significant assumptions. However, the Note would benefit from a description of how to evaluate any variances between management's assumption and the auditor's expectation.

Developing an Independent Expectation of the Estimate

There are inconsistencies in practice in the manner in which management and auditors may interpret or calculate a potential misstatement in an estimate. Auditors often develop point estimates and determine an appropriate range around such point estimate, or develop an audit range against which to compare to management's point estimate. The range cannot be more precise than the estimate itself and, as stated in paragraph .25 of the Proposed Standard, the range should be appropriate for identifying a misstatement.

(Q29) We believe additional guidance regarding establishing an appropriate audit range would be helpful, specifically with regard to the Board's expectation around how the auditor should support its determined range with sufficient appropriate audit evidence. In some instances, a range may be supported by empirical data, but in other cases it may be determined based on auditor judgment.

We also believe additional guidance on how to evaluate management's point estimate against the determined auditor's range for purposes of evaluating whether a misstatement exists would be beneficial. For example, if management's point estimate is within the auditor's reasonable range, a difference need not be evaluated as a misstatement. Paragraph .25 of the Proposed Standard indicates that the range should be supported, but in the instance when a point estimate is determined in addition to a tolerable range around that point estimate, it is unclear whether or how this guidance still applies. Similarly, paragraph .13 of AS 2810, *Evaluating Audit Results*, is unclear on how to determine the amount of the misstatement specific to point estimates with a tolerable range. The complexity of an estimate and the amount of objective inputs and empirical data is also a consideration (i.e., contrasting investment securities with business valuations). In addition, we encourage the Board to include examples of how an auditor might evaluate management's point estimate for bias when the auditor is using a range.

Comments on Appendix A – *Special Topics*

(Q31) We commend the PCAOB for recognizing that pricing information generated by pricing services used in making accounting estimates generally tends to have different characteristics than data or assumptions used for other estimates, and that audit evidence from these sources should be evaluated against the same criteria when determining relevance and reliability regardless of whether it is accumulated by testing management's process or developing an independent estimate. Further, we also agree that pricing information should be evaluated differently when obtained from brokers or dealers. We encourage the Board to consider including the three characteristics identified starting on page A3-35 of the Proposal, as an expansion to the concept covered by paragraph .A3(a). With regard to the requirements when auditing the fair value of financial instruments included in Appendix A – *Special Topics* of the Proposed Standard, we have the following comments:

Identifying and Assessing Risks of Material Misstatement Related to the Fair Value of Financial Instruments

(Q32 and Q41) Both paragraphs .20 and .A2 of the Proposed Standard refer to AS 2601, *Consideration of an Entity's Use of a Service Organization*, if the third party is part of the company's information system over financial reporting. We believe that the auditor's understanding of the company's use of service organizations and specialists should be considered when assessing risks of material misstatement related to the fair value of financial instruments. However, we suggest that further consideration as to whether merely receiving prices from third-party pricing sources in and of itself amounts to using a service organization.

If auditors consider only the criteria in AS 2601.03, it is likely that third-party pricing services will often be considered service organizations. We believe that criteria is insufficient without the content in AS 2503.11 through .14 which outlines relevant considerations specific to financial instruments. Notwithstanding the applicability of the definition of a service organization to a third-party pricing service, the relatively low risk posed by the receipt of such information does not warrant, in our view, subjecting the arrangement to the requirements imposed on the auditor under the service organization literature. We recommend that the footnotes in the Proposed Standard that reference to AS 2601 be deleted.

Our experience causes us to believe that evaluating controls at third-party pricing services will be challenging for both management and auditors. The pricing services are reasonably transparent with their processes and will walk through pricing for a sample of securities.

However, the availability, form, and content of service organization internal control reports from pricing services is inconsistent.

Additionally, the degree to which pricing services provide transparency into the inputs for any specific security on a routine basis varies, which could present operational difficulties in performing the procedures outlined in the Proposed Standard. We recommend that the Board seek additional input from the pricing services about the additional time and costs associated with developing the documentation that auditors would expect to request from management, or obtain directly from the pricing services, in order to comply with the Proposed Standard.

We also recommend that the Board add wording to the proposed amendment to AS 2110.28, using language similar to the existing note on evaluation of risk and controls within the information system, to clarify that the service organization is part of the evaluation, not a separate consideration.

Additional Risk Assessment Consideration

AS 2503 contains additional risk assessment considerations for financial instruments and derivatives such as the complexity of the instrument, external factors that impact the derivative, and the company's experience with derivatives. Because the risks of material misstatement may vary in derivative products, we suggest retaining this AS 2503 content in an appendix to the Proposed Standard.

In addition, paragraphs .23 and .24 of AS 2502 may also help the auditor design substantive procedures and would also be useful to retain.

(Q34) *Using Pricing Information From Pricing Services*

Paragraph .A3 could be enhanced by clarifying the meaning of "uniform pricing information." From our understanding, certain pricing services prepare pricing information upon client request, but follow uniform procedures that cause the preparer of the specific information to be unaware of the identity of the user and there is often no bias of the user introduced into the process. In those circumstances, footnote 3 would seem to be inapplicable as the pricing service is likely providing a more specialized service than acting as specialist as contemplated by AS 1105.

We agree conceptually with the three factors in paragraph .A4 that affect the reliability of pricing information provided by pricing services, but believe further clarification would be helpful:

- The requirement in paragraph .A4a use "types of financial instruments" which seems to apply broadly to the asset class coverage of a pricing service (e.g., municipal bonds) as compared to the "financial instrument being tested" in paragraph .A4b (e.g., a specific municipal bond sampled from a larger portfolio).

We are not clear as to whether paragraph .A4b requires the evaluation of whether the methodology used for municipal bonds would result in an estimate in conformity with the applicable financial reporting framework or how such methodology was applied to the specific municipal bond in conformity with the applicable financial reporting framework. Based on our experience, the pricing services establish methodologies for the asset classes they price, and these methodologies consider multiple observable data points when producing an evaluated price(s). If the intent of paragraph .A4b is for the auditor to evaluate the methodology applied to each item tested, we believe it may create an undue cost and burden on the pricing service, and then on the companies and auditors, to provide the specific method used for any one security at any point in time. Further, we are unclear as to how the statement on page A3-34 that the Proposed Standard does not require audit procedures to be applied to each individual financial instrument, similar to the Existing Standards, is to be considered in this context.

- We believe the requirement about the experience and expertise of pricing services could benefit from additional specificity as to what is expected, thereby preventing inconsistencies in how auditors evaluate this criteria. The PCAOB may wish to provide more guidance on the frequency of evaluating the experience, expertise, and methodology of a pricing service, including when an additional evaluation may be necessary. For example, what would be the expectation of the auditor, as to the nature, timing, and extent of procedures when there are significant changes within an organization, such as a merger or redistribution agreement between pricing services?

- While we acknowledge that the three factors outlined in paragraph .A5 are relevant to financial instruments because they are factors in evaluating the application of the financial reporting framework and fair value hierarchy, we believe data analysis of multiple pricing services could obviate the need to consider this level of detail at the individual financial instrument level across many asset classes. Data provided today by many pricing services does not readily distinguish all of the attributes in paragraph .A5 at the financial instrument level.

- The determination of whether and how similar financial instruments relate to the fair value estimate provided by pricing services is subjective and not transparent at the financial instrument level for all prices from vendors without incremental cost and effort. We believe paragraph .A6 of the Proposed Standard would be

> sufficiently addressed if an auditor were to centrally evaluate the process through which a pricing vendor identifies and uses data about similar financial instruments when arriving at an evaluated price without needing to know the exact process for each specific financial instrument.

Sufficient Appropriate Audit Evidence – Single or Multiple

Observable market data such as exchange activity is contrasted with what the third-party pricing services often refer to as "evaluated prices," which are estimates that generally use observable data as inputs. Only 1-2% of bonds trade daily, and most of those trades are Treasury or Agency bonds. The pricing services have designed systems and processes to develop and frequently refresh their estimates to be based principally on observable inputs which include, but are not limited to, recent trades and matrix pricing. In more limited circumstances, unobservable inputs are considered, but are typically not significant to the evaluated price. For this reason, we think that paragraph .A6 will be applicable in the majority of circumstances, and paragraph .A7 will be applicable less frequently. For this reason, we believe these paragraphs could provide greater specificity as to the nature and extent of additional audit procedures necessary when relevance is affected by paragraphs .A5b or .A5c. Pages A3-35 to A3-39 of the Proposal provide a good deal of insight on the Board's expectations. In order to increase consistent application of the Proposed Standard, we encourage the Board to bring more of these concepts into the Proposed Standard.
Page A3-37 of the Proposal acknowledges that there may be circumstances where the auditor is unable to perform the procedures required in Appendix A of the Proposed Standard, and would need to perform alternative procedures (e.g., engaging a specialist to assist the auditor in developing an independent estimate). We recommend the Board consider including this guidance as part of paragraphs .A5-.A7.

(Q36) We agree with the concept that when multiple pricing sources are used, less information is needed about the particular methods and inputs used by the individual pricing services. Each pricing service views their models as proprietary intellectual property and it may not be feasible to evaluate the methods and assumptions in the manner envisioned by the Proposed Standard.

However, we believe that additional guidance could be provided about what constitutes "less information" and how to use the information from multiple sources. Page A3-37 indicates obtaining pricing information from a different pricing source would be an additional procedure. However, obtaining another price does not definitively resolve which estimate is the best estimate. When evaluating multiple pricing sources, we believe an average of a reasonable number of available prices, excluding prices that statistical or other objective evidence indicate are outliers, is the method that the Proposed Standard should require. In addition, procedures such as those outlined in paragraph .A4 should be performed for at least one source to serve as the basis for which relevance of other prices may be established.

Given the widespread availability of market pricing data on public websites such as Google and Yahoo, we believe consistent execution across the profession would be enhanced if the Proposed Standard clarified whether or how such sources of pricing may be used by an auditor. These websites would generally not be characterized as pricing services and do not offer a level of transparency about their data transmissions that is contemplated by the Proposed Standard.

Page A3-39 of the Proposal indicates that a representative price would not necessarily be closest to the company's price but rather based on available information about the pricing services and the instrument, and would likely reflect market price. We think this guidance should be included in the Proposed Standard.

Trade Volume Information

(Q34) Transaction information (with the exception of company-specific transactions) is generally unavailable to most third parties, including management and auditors. Because of the lack of trade volume for many financial instruments, pricing service processes are designed to maximize observable data, which includes recent trades when available, and to use other observable data when trades are not available. In addition, there is not one source where all trade data is maintained. For example, brokers or dealers who are FINRA member firms have an obligation to report over the counter transactions in corporate bonds and securitized instruments to TRACE[1] under an SEC-approved set of rules. Although TRACE is a significant source of trade data, not all data collected through this process are redistributed to the marketplace.

When multiple pricing services are used, the auditor may use quantitative, statistical, historical, and current comparisons to identify evaluated prices that do not appear to align with the conditions in paragraph .A8b-d, making consideration of paragraph .A8a unnecessary.

We suggest that paragraph .A8 be revised to combine the concept in .A8a with .A8d as follows:

> d. The pricing information for the financial instrument is generally based on inputs that are observable, including recent trades of the financial instrument or of financial instruments substantially similar to the financial instrument being tested.

We encourage the PCAOB to obtain feedback from the pricing services on the level of information they are able and/or willing to provide. Although pricing services may willingly

[1] See http://www.finra.org/industry/trace

change their processes and data to adapt to new requirements, the incremental benefit may not contribute to audit quality in a way that correlates appropriately with the cost. We suggest that the Board endeavor to specify objectively determinable methods of valuation so that a pricing service could indicate whether the prices provided were determined in accordance with a particular method, which in turn would allow management and auditors to align their testing effort against those principles. Doing so would also promote uniform application in the development by pricing services of evaluated pricing in line with methods that are transparently aligned with the Board's expectation.

Centralized Evaluation of Pricing Information

(Q35) Page A3-38 indicates that the Proposed Standard would continue to allow centralized groups to assist in performing procedures related to testing the fair value of financial instruments. Footnote 50 of the Proposal describes certain activities of such centralized groups that would be subject to the supervision requirements of AS 1201, *Supervision of the Audit Engagement* (AS 1201), including evaluating the specific methods and assumptions related to particular instruments, identifying and assessing risks of material misstatement, and evaluating differences between a company's prices and a pricing service's price.

We appreciate the Board's acknowledgment that the centralized evaluation of the pricing information is efficient and effective in the consistent evaluation of pricing services' methodologies, controls, and pricing information in response to paragraph .A4 at the asset class level. We believe that uniform application of these concepts could be enhanced if additional guidance or more precise requirements about the extent of what may be executed by a centralized group and provided to individual engagement teams, or more specifically, an engagement partner, were provided in either AS 1201 or the Proposed Standard. We believe that many of the risks of material misstatement associated with financial instruments, particularly when measured at fair value using observable inputs, reside at the specific instrument level and are agnostic to the entity holding the financial instrument. We recommend that the Proposed Standard permit the audit evidence accumulated by performing centralized audit procedures to be considered and used by individual engagement teams, except if there is an entity-specific risk not directly associated with the instrument. For example:

- Centralized conclusions on the relevance and reliability of specific pricing sources and specific securities may be used by individual engagement teams without further evaluation.
- Engagement teams may use centralized risk assessment at the asset class and security level supplemented by whether any entity-specific risks exist, such as management override of pricing information.

- Centralized data analytic tools may be used to test company portfolios against pricing information, with conclusions on measurement (the "price") provided to engagement teams.

Using Pricing Information From a Broker or Dealer

(Q37) We believe paragraph .A9 could be more explicit with respect to evaluating the relevance and reliability of audit evidence when a company's fair value measurement is based on a "broker quote." Specifically, we believe the discussion on page A3-40 regarding how to think about the qualifiers would be beneficial to include in the Proposed Standard. That guidance states that "generally" broker quotes provide more relevant information when certain criteria are met and implies that the criteria are necessary to obtain sufficient appropriate audit evidence over the broker quote.

We believe this requirement will result in a significant change in practice because the five criteria are bound with "and," and the relevance of this criteria is further reinforced by the Note. While we agree in concept about the need to enhance how broker or dealer quotes are evaluated as audit evidence, we suggest the Board consider whether there will likely be lower risk circumstances for which a broker quote may be sufficient appropriate audit evidence without meeting all criteria. For example, an executable broker bid may be viewed as relevant reliable audit evidence even if not from a market maker (in practice, there is no standard definition of a market maker). Without additional guidance, we are concerned that it will be difficult for auditors to consistently and objectively determine when additional procedures should be performed before considering the evidence reliable.

Unobservable Inputs

The guidance in the Proposed Standard relating to unobservable inputs is limited as compared to the existing AS 2502. Paragraph .18 of the existing AS 2502 provides guidance on auditing a fair value measurement when observable inputs are not available. While evaluating management's models are incorporated into the Proposed Standard, paragraph .A10 of the Proposed Standard could be expanded to include the prior guidance on auditing unobservable inputs. For example, the guidance included in paragraphs .05, .06 and .08 of the existing standard may be beneficial to include in the Proposed Standard.

Comment on Auditing Standards Amended by the Proposal

Amendments to AS 1105

Disclaimers of information and restrictions on the use of information: With regard to the Note to be added to paragraph .08 of AS 1105, while we agree that restrictions, limitations, or disclaimers should be evaluated for the effect on the reliability of audit evidence, we believe additional guidance on how to evaluate the potential effects would be useful, in order to drive greater consistency among auditors in this area.

(Q39 and 40) *Audit Evidence Regarding Valuations Based on Investee Financial Condition or Operating Result*s

The conforming amendments to AS 1105 expand on the requirements in AS 2503 when fair value is based on an investee's financial condition or operating results that are a significant input to fair value. We believe that these requirements may be difficult to practically apply to specific fair value measurements.
The Note to paragraph .A4, including footnote 5, acknowledges that ASC 820 permits, when conditions are met, net asset value (NAV) to be used as a practical expedient of fair value. We believe the Proposed Standard could be enhanced to more clearly articulate the requirements for testing the investments that meet the criteria to be recorded at NAV, as a practical expedient.

Similar to investee financial information, the NAV information may only be available from the instrument's issuer. This NAV is often only published by the investee fund, not through an exchange or a third-party pricing service. In addition, there are no publicly available market transactions to support the NAV and often times the NAV is solely evidenced by values provided by the investment manager without underlying audited financial statements available to support the company's year-end investment (due to the timing of the release of the audited financial statements or differing balance sheet dates). Current practice generally involves obtaining evidence that the criteria to use NAV as a practical expedient has been appropriately applied, and testing the accuracy of the NAV used or applying analytical techniques to roll forward the value from the date of the last audited financial statements, depending on the length of the gap period.

Paragraph .A2(d) of AS 1105 adds a requirement to identify if the available financial statements of an investee were audited in accordance with PCAOB standards. Further, footnote 56 on page A3-44 of the Proposal makes clear that the auditor is to consider the difference in audit procedures that may have been necessary to obtain sufficient appropriate audit evidence under PCAOB standards. We are concerned that this requirement will not be operational without undue cost because many investee financial statements are audited in accordance with other auditing standards, and paragraph .A3 does not indicate how the auditor should respond if the audit is performed in accordance with another set of standards.

We believe that the intended applicability of the amendments could be enhanced. The Note to paragraph .A1 of Appendix A does not incorporate the additional discussion on page A3-43, including footnotes 54 and 55 of the Proposal, to better distinguish between which equity method investments are included in the conforming amendment to AS 1105 and which equity method investments are subject to AS 1205, *Part of the Audit Performed by Other*

Independent Auditors (AS 1205). Footnote 1 on page A2-10 notes that guidance on equity method investments (where the net assets are recorded based on underlying financial statements) does not apply if the investee financial information is audited by an auditor other than the principal auditor, or the other auditor is supervised under AS 1201 or the work of the other auditor is used under AS 1205. AS 1205 notes that investments accounted for under the equity method (where the underlying audit report is used to record the investor's equity in the underlying net assets) are in the position of a "principal auditor using the work and reports of other auditors." While the guidance appears consistent, it is unclear which equity method investments do not fall under AS 1205, unless audited financial statements are not available.

Other

(Q12 and Q14) We believe that the Proposed Standard should be applicable to audits of emerging growth companies (EGCs). In our experience, estimates are frequently encountered when auditing an EGC. Because users of financial statements of EGCs generally have less visibility into the companies, as noted by the Board, and because auditing estimates often involve a level of auditor judgment, there is an increased importance on quality and consistency in the application of auditing standards related to the auditing of estimates.

Likewise, we also believe that the Proposed Standard should be applied to audits of brokers and dealers. We agree with the Board's assertion that having different standards for auditing estimates for some entities (i.e., EGCs and brokers and dealers) has the potential to create confusion and may require audit firms to maintain different methodologies for auditing estimates.

(Q15) We believe that the simultaneous adoption of the Proposed Standard and the *Proposed Amendments to Auditing Standards for Auditor's Use of the Work of Specialists* (the Specialist Proposal) would result in significant efficiencies and prevent inconsistencies in their application. The use of a specialist in an audit frequently occurs in connection with auditing an accounting estimate, and the Proposed Standard and the Specialist Proposal include references to each other.

If the final standard and related amendments are approved by the SEC on or before June 30, 2018, we would support the standard and amendments becoming effective for audits of periods ending on or after December 15, 2019. We believe this would allow sufficient time for audit firms to make the necessary adjustments to their system of quality controls and update their methodologies, guidance, tools, and templates and to develop and provide training.

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We appreciate the Board's and Staff's careful consideration of our comments, and welcome the opportunity to discuss our comments further with the Board and Staff. If you have any questions regarding our comments included in this letter, please do not hesitate to contact Ilene Kassman (212-909-5667 or ikassman@kpmg.com).

Very truly yours,

KPMG LLP

cc:

PCAOB

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Lewis H. Ferguson, Board Member
Jeanette M. Franzel, Board Member
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