DUFF & PHELPS

August 30, 2017

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, DC 20006-2803

Reference: ***PCAOB Rulemaking Docket Matter No. 043 (PCAOB Release No. 2017-002)***

Dear Board and Staff:

We welcome the opportunity to comment on your *Proposed Auditing Standard – Auditing Accounting Estimates Including Fair Value Measurements* and proposed amendments to other PCAOB auditing standards (the "Estimates Proposal"). As the leading provider of qualified, experienced and credentialed third-party valuation support to public registrants and investment company managers, we have unique insight and experience with respect to the rigor and support preparers of financial statements utilize in estimating fair value and the scrutiny auditors apply in auditing fair value measurements.

Our role in the financial statement preparation process is distinctive. We support management in enhancing its internal control process with respect to estimating fair value, and our fair value analyses serve as an input for consideration by management in preparing its financial statements. We believe that our consultative advisory process results in more relevant and reliable fair value estimates. As such, our role is that of company-engaged (or third party) specialists, as described in the Specialists Proposal.

Our comments are derived from years of experience assisting management with its valuation estimates. In 2016 alone we performed more than 12,000 engagements for 5,000 clients, including nearly half of the S&P 500, over 70% of top tier private equity firms and 64% of Fortune 100 companies. Our professionals are deeply involved in industry efforts to enhance valuation consistency and transparency, including participation on various task forces and working groups of the AICPA and The Appraisal Foundation; on boards, such as the International Private Equity and Venture Capital Valuation Board, and the International Valuation Standards Council; and in the Fair Value Quality Initiative.

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We have previously responded to PCAOB's Staff Consultation Paper on *Auditing Accounting Estimates and Fair Value Measurements* (2014) and the PCAOB Staff Consultation Paper on *The Auditor's Use of the Work of Specialists* (2015). We have also participated in the SAG meetings on this topic. Presently, we are also separately responding to PCAOB's *Proposed Amendments to Auditing Standards for Auditor's Use of the Work of Specialists* (the "Specialists Proposal").

Our goal in responding to the Estimates Proposal is to provide our expertise as experienced third-party valuation specialists as the PCAOB considers changes to audit standards which, in turn, will guide the accountability of auditors in exercising their role in capital markets - ensuring that financial information meets the needs of investors and is provided on a reliable, high-quality, consistent, transparent and cost-effective basis

Key Observations

We understand that the Estimates Proposal is broader than auditing fair value estimates. Given the prominence of fair value in financial reporting and our specific expertise in assessing fair value, our comments and observations are directed specifically to auditing fair value measurements, and are written from the perspective of **experienced, credentialed, company-engaged third party specialists.**

PCAOB's Auditor Guidance Must Reflect Important Recent Developments Affecting Valuations for Financial Reporting

We applaud the PCAOB's focus on risk-based auditing of fair value measurements. The Estimates Proposal, however, does not consider recent key developments affecting valuations for financial reporting purposes, which we believe will have a direct impact on advancing the quality of documentation and support for fair value estimates. The Estimates Proposal should be enhanced by incorporating reference to and giving effect to the impact to these developments. These events include the establishment of the "Fair Value Quality Initiative", tasked with the creation of a valuation professional infrastructure, the subsequent launch of the CEIV (Certified in Entity and Intangible Valuations) credential, and the pending launch of the CVFI (Certified in Valuations of Financial Instruments) credential.

The Fair Value Quality Initiative was undertaken in response to statements made by regulators (SEC) calling for increased quality and accountability of valuation specialists performing valuations for financial reporting purposes. The resulting CEIV credential (launched in January 2017) is designed for both management (company-employed) and third-party (company-engaged) valuation specialists who perform fair value measurements for financial statement reporting purposes. To obtain and maintain the credential, the valuation professional: (1) must meet rigorous qualification, as well as ongoing education and experience requirements; (2) must adhere to the requirements of a Mandatory Performance

Framework (MPF)[1], which governs the scope of work and level of documentation; and (3) agrees to be subjected to a periodic independent Quality Control review.

Adherence to the MPF is mandatory for CEIV credential holders and is considered best practice for non-CEIV valuation specialists; the same holds for the CVFI, with an equivalent Disclosure Framework (DF). We believe that both the CEIV and CVFI credentials and related MPF and DF will further enhance the robustness and quality of company-employed and company-engaged valuation specialists' work, and will have a direct impact on the quality of documentation and support for fair value estimates. The MPF lays out detailed requirements and procedures addressing the depth of analysis and documentation necessary to prepare a professional work product that will be used by management for financial reporting purposes. This includes a critical assessment by the valuation specialist of data and projections provided by management, significant assumptions used, and other inputs to the valuation analysis, and a thorough documentation thereof. This will further enhance the quality of management's fair value assertions, and thereby will make the audit more efficient and more cost-effective, to the benefit of all parties involved.

However, notwithstanding the new valuation infrastructure in place, the new MPF/DF requirements, and the expectation that a CEIV's/CVFI's work is subject to an independent Quality Control review, we did not clearly discern that the Estimates Proposal takes advantage of the new framework and would supportively guide auditors to adjust their procedures, where appropriate, and re-define the scope of various audit efforts - including testing, reperformance and analytical procedures, or development of independent estimates – in a way that takes into account MPF/DF-compliant specialist work and documentation.

We believe that the Board should consider the results of the Fair Value Quality Initiative which was undertaken at the behest of the SEC.

Risk of Unnecessarily Expanding Audit Procedures

As previously noted, we support the "risk-based" approach to auditing fair value measurements. However, the wording of the Estimates Proposal, as currently drafted, is subject to broad interpretation which may result in even greater incremental, and at times duplicative, auditor effort when auditing fair value measurements.

The MPF/DF covers many, if not all, of the key concepts identified in the Estimates Proposal with respect to what auditors should be looking for in assessing management's fair value estimates. We are concerned that failing to reflect the impact of the MPF/DF in the Estimates

[1] The *Mandatory Performance Framework* document, and its companion document, the *Application of the Mandatory Performance Framework*, *collectively referred to as "MPF" for the purpose of this letter*, can be located here: https://ceiv-credential.org/mandatory-performance-framework-and-application/

Proposal could lead to unnecessarily expanding audit procedures and could potentially increase overall costs with little additional benefit.

An experienced and credentialed company-employed or company-engaged valuation specialist complying with the new MPF/DF should be able to develop relevant and reliable fair value estimates. Auditors can and should test the company's process - which may utilize engaged specialists, as applicable - to develop such estimates. However, when such testing by the auditor demonstrates that management's fair value assertions are reasonable, and credentialed company specialists were part of the process, providing consultative support, the auditor should not feel compelled to extend testing. The current draft may inadvertently encourage auditors to unnecessarily expand the audit approaches utilized (Proposed Auditing Standard AS 2501 paragraph .07). By referencing the MPF/DF and applicable certifications, the Estimates Proposal could provide better guidance and confidence to auditors in making their risk-based judgments, and thereby establishing the extent of testing required.

The increase in costs in the system may be pervasive and far-reaching, as there may be a spillover effect on private company audits as well. It would be difficult to conceive that an auditor would behave differently and exercise a different level of skepticism and professional care in a public vs. a private company audit, even though separate audit methodologies may be maintained.

Risk of a Decrease in the Overall Quality of Financial Reporting

The audit guidance in the Estimates Proposal should communicate a clearer recognition of the beneficial, value-adding, time- and cost-saving impact on the audit process of a qualified and credentialed company specialist, who complies with performance standards, and is subject to independent Quality Control and a code of professional conduct and ethics.

We believe that the Board's intent is to improve audit quality in a cost-effective manner, so as to benefit investors and promote investor protection. However, if the auditor is generally encouraged, expected, or feels obliged to perform more procedures and incur more effort, regardless of the involvement of a qualified company specialist, this could shift the balance between the work of the company specialist and the auditor specialist (as acknowledged in the Specialists Proposal) with negative effects, including degradation of the output of the internal control environment, and potential impairment of auditor independence.

We recognize that management earnestly exercises its responsibility to prepare GAAP-compliant financial statements providing users with relevant and reliable financial information. However, if faced with the prospect of increasing audit scope and costs, situations may arise where management may feel compelled to invest less time, cost and effort in supporting certain assertions in the financial statements by not engaging a specialist when one would otherwise be called for - especially given the expectation that the auditor's specialist would perform extensive testing and calculations as part of the audit.

This outcome could decrease the quality of financial reporting and may also create situations in which auditor independence could be deemed impaired because the auditor's specialist is de facto providing management with estimates, which the auditor must review and audit.

Overall, these factors pose a risk of creating an environment that not only does not meet the PCAOB's objectives in the rewriting of this standard, but also fails to foster the best outcome for investors.

Credentialed Company Specialist MPF/DF Compliance Should Enable Auditors to Appropriately Adjust their Scope of Work

Auditors' risk assessment and audit scope should consider management's and its company specialists' compliance with the MPF/DF in developing fair value estimates, and auditors should be able to tailor their procedures accordingly.

MPF/DF compliance directly impacts the specialists' *scope of work, depth of analysis and documentation* as it relates to fair value measurements, and a CEIV/CVFI credential further signals that the specialist's work may be subject to an independent Quality Control review by the organization issuing the specialist's credential. These are key safeguards of valuation quality that should be made explicit in the Estimates Proposal - and should be considered as significant factors in the auditors' risk assessment and resultant scope of work.

Company Specialists - and Particularly Company-Engaged Specialists - are an Enhancement to Management's Internal Control Process

As previously noted, management is responsible for the assertions contained in the financial statements and cannot relinquish this role to a third party. However, management can enhance its process by obtaining consultative advice from experienced valuation specialists.

Typically, management has sought assistance from third party valuation specialists in complying with financial reporting requirements related to business combinations, impairment testing and share-based compensation, among others. Additionally, it has become best practice of the largest private equity and hedge fund investment managers to validate fair value estimates using a qualified, experienced third party valuation specialist. Investors have come to rely on enhanced internal control systems which appropriately include specialized valuation expertise. In these situations, the valuation specialist is engaged to assist management, by providing consultative advice, in fulfilling management's responsibility of supporting the assertions included in the financial statements.

As such, management should not be put at a disadvantage for using qualified and credentialed company-engaged or company-employed specialists. The prospect of a broadly increased audit mandate (issues previously discussed) despite the use of qualified company specialists (employed and/or engaged) seems to be at odds with such an internal control enhancement that management has traditionally utilized.

Presumption of Bias

We think that the presumption of bias is over-emphasized in the Specialists and Estimates Proposals, collectively. When a professional (in this case, an auditor) has a questioning mind and applies a healthy degree of professional skepticism in performing his/her job, it does not imply that the subject or party to the inquiry (management) is inherently biased.

Professional skepticism (which includes evidential skepticism and self-skepticism) is an attitude, rather than a verdict on the character or actions of those to which the inquiry is addressed. Overemphasizing the potential for any bias, against the backdrop of an already robust PCAOB inspection process, and existing robust review procedures of the work of company specialists, could lead to behavior that is reactionary and results in unnecessarily expanding audit procedures with arguably little incremental benefit. Management has a duty of care, engaged specialists abide by duty of care and ethics standards, as do auditors. The current tone may inadvertently promote a negative perception that management and its employed or engaged specialists will always be biased against exercising proper care. Such a premise is without general merit.

The benefit of professional skepticism and the instruction to rely on persuasive evidence can be highlighted without casting management, specialists, or auditors in a negative light. Professional skepticism is also consistent with the approach taken by the MPF/DF and reflected in the work performed by the CEIV- (or CVFI-) credentialed company-employed or company-engaged specialist.

Conclusion

We appreciate the opportunity to comment on the Estimates Proposal. We fully support the Board’s efforts to set standards that result in high quality audits.

We believe that without appropriate amendments, in the current regulatory and financial reporting environment, the proposed guidance in the Estimates Proposal (and the companion Specialists Proposal) will likely lead to auditors significantly and unnecessarily expanding procedures, with limited incremental benefit. Thus, we urge the PCAOB to reconsider certain aspects of the guidance, and the overall tone and direction of the Estimates and Specialists Proposals, collectively.

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Subject to our foregoing comments, in *Appendix A below,* we have provided comments, by paragraph, on the proposed amendments in Appendix 1 (AS 2501) of the Estimates Proposal. In *Appendix B below*, we have also provided responses to certain specific questions posed in the Estimates Proposal.

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We would be pleased to further discuss our comments with the PCAOB staff. Please direct any questions to any of us via the contact information set forth below.

Sincerely,

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Appendix A

Specific Comments on Proposed Auditing Standard AS 2501, *Auditing Accounting Estimates, Including Fair Value Measurements*

Paragraph .07.

We are concerned that the wording of paragraph .07 could lead to over-auditing, as many auditors may decide to apply all three approaches to avoid being second-guessed by inspectors. We believe this risk could be mitigated if the wording were modified similar to the following:

> *.07 In performing substantive procedures to respond to the identified and assessed risks of material misstatement associated with accounting estimates, the auditor should test an accounting estimate by assessing the company's process used to develop the accounting estimate (see paragraphs .09-.20 of this standard). In the steps the auditor undertakes to evaluate the company's process, consideration should be given to recognized performance standards that the company or its engaged specialists have complied with, in connection with developing the accounting estimate.*
>
> *If the auditor deems that management's process, including the impact of a qualified specialist, does not provide reasonable support for the estimate, then the auditor should consider developing an independent expectation for comparison to the company's estimate (see paragraphs .21-.26 of this standard) (care should be taken such that the auditor does not inadvertently provide the estimate for use by management). If appropriate, depending on the nature of the estimate, evaluate audit evidence from events or transactions occurring after the measurement date related to the accounting estimate for comparison to the company's estimate (see paragraphs .27-.29 of this standard).*

Otherwise, as this section is currently drafted in the Estimates proposal, there is a risk that auditors will choose to perform all three substantive approaches outlined in the draft, absent language advising more explicitly that there is no need to apply more than one approach, and certainly no need to apply all three approaches.

Thus, even though the proposal does not require the auditor to use all three approaches, against the backdrop of an already robust PCAOB inspection process, the ambiguity as to which of the three substantive approaches should be used could lead to unnecessarily expanding audit procedures with arguably little incremental benefit.

Paragraph .12.

> *.12 AS 1105, Audit Evidence, requires the auditor, when using information produced by the company as audit evidence, to evaluate whether the information is sufficient and appropriate for purposes of the audit by performing procedures to: (1) test the accuracy and completeness of the information or to test the controls over the accuracy and completeness of that information, and (2) evaluate whether the information is sufficiently precise and detailed for purposes of the audit.*

We recommend adding a footnote to clause (1) above which states:

> "*For example, with respect to fair value measurements, management's controls and process should be consistent with the Fair Value Quality Initiative's MPF/DF, which will impact the extent of additional testing required by the auditor."*
>
> And,
>
> *"The auditor should consider, in setting the scope of audit procedures and determining the extent of testing required, if the fair value estimate has been developed in compliance with the MPF/DF, in which case the development of an independent estimate may not be required."*

For reference, the MPF states (MPF, par. 2.17):

> *"When evaluating management-generated and management-provided information, the valuation professional must consider the experience of management and the sufficiency of the documentation and analyses provided by management throughout the valuation engagement. The valuation professional should not presume management is biased; however, the valuation professional should not accept and rely on less-than-persuasive evidence because the valuation professional believes management is unbiased. This requirement extends to third-party specialists retained by management, their competence, and the sufficiency of their work product."*

Additionally, the MPF requires an assessment of whether the company's prospective financial information (PFI) is representative of expected value and properly supported, and requires its evaluation for reasonableness in general, as well as in specific areas. For example, factors and common procedures to consider when assessing PFI may include, but are not limited to:

- Comparison of PFI for an underlying asset of the subject entity to expected values of the entity cash flows.
- Frequency of preparation.
- Comparison of prior forecasts with actual results.
- Mathematical and logic check.
- Comparison of entity PFI to historical trends.
- Comparison to industry expectations.
- Check for internal consistency.

Paragraph .27, footnote 22.

We recommend making the following edit, to appropriately reflect one of the concepts underlying fair value measurements:

> *Evaluating audit evidence from events or transactions occurring after the measurement date, as contemplated in this standard, is a substantive test and thus differs from the review of subsequent events performed pursuant to AS 2801, Subsequent Events. See also paragraph .11 of AS 1015, Due Professional Care in the Performance of Work (as proposed to be amended – see Appendix 2), which provides that the auditor's evaluation of accounting estimates is to be based on information that could reasonably be expected to be available through the date of the auditor's report, or for fair value measurements, information that was known or knowable at the measurement date.*

Other Specific Comments

Page A3-18, par. 4, Company's use of a Specialist or Third-Party Pricing Service

We have the following observations:

- When auditing fair value estimates, the Board should consider differentiating between a company-employed or company-engaged valuation specialist, a pricing service (which in certain contexts may be considered a specialist), and a broker providing quotes (not considered a specialist). Values received from pricing services (data aggregators) and brokers should be evaluated for their relevance and reliability and whether they meet the ASC 820 fair value framework requirements. Prices and quotes should be contemporaneous and actionable or reflective of recent orderly transactions. If pricing service prices or broker quotes are not reflective of a traded price (an offer to buy or sell), they should be augmented by other valuation support. Informed judgment is required to identify market participant assumptions.

- Reference to the MPF/DF with respect to fair value measurements would make the requirements clearer. Further, it should be acknowledged that for some fair value estimates, a reasonable fair value range may exceed materiality. Applying additional auditing procedures will generally not reduce the reasonable range depending on the applicable market participant assumptions.

- Finally, when management uses a company-employed or company-engaged specialist, the auditor should be able to take "credit" for the enhanced reliability of the resultant fair value estimates, when assessing management's valuation process and its sufficiency in providing audit evidence.

Appendix B

Responses to Certain Specific Questions

Question:

1. **Does the discussion of the reasons to improve auditing standards sufficiently describe the nature of concerns related to auditing accounting estimates that the Board should address? Are there additional concerns that the Board should seek to address?**

   Response

   The reasons for improving auditing standards are well articulated. However, we are concerned that the Estimates Proposal may result in unnecessarily expanding audit procedures, increasing cost, with little corresponding benefit.

Question:

3. **Are there additional changes needed to improve the quality of audit work related to accounting estimates that the Board should include in its proposal?**

   Response

   As noted in our general comments, the proposed standard should reference the Fair Value Quality Initiative, the new valuation credentials, and the applicable valuation MPF/DF frameworks. We acknowledge that such reference is applicable to auditing fair value measurements, and that corresponding credentials may be applicable with respect to auditing other estimates.

   However, given the prominence of fair value measurements in the proposed standard, we believe that the PCAOB should consider the results of the Fair Value Quality Initiative which was undertaken at the behest of the SEC. In addition, it would be appropriate for the auditor's specialist to have the same or similar credentials to those of company's specialists (for example, a CEIV/CVFI credential, if auditing fair value measurements).

Questions:

8. **The Board requests comment generally on the potential benefits to investors and the public. Are there additional benefits the Board should consider?**

11. **The Board requests comment generally on the potential unintended consequences of the proposal. Are the responses to the potential unintended consequences discussed in the release adequate? Are there additional potential**

unintended consequences that the Board should consider? If so, what responses should be considered?

Response

Users of financial statements benefit when the quality of financial information is enhanced. Management should be encouraged to follow practices such as the MPF/DF and utilize experienced, knowledgeable and credentialed support where applicable. When management's internal control process is enhanced by the consultative expertise of qualified, credentialed specialists, the quality of information increases and benefits users of the financial statements.

Investors will also benefit if the audit standards appropriately recognize the safeguards of valuation quality (e.g., credentials specifically for financial reporting, valuation performance standards), so as to give auditors confidence in their risk assessment and enable them to adjust their audit scope and procedures, where appropriate.

However, as discussed under Key Observations earlier in this letter, the proposal as drafted may encourage auditors to unnecessarily expand audit procedures, and lead to an increase in costs with little corresponding benefit. Failing to reference the Fair Value Quality Initiative may not be supportive of management improving the reliability of fair value measurements.

When management's internal control process is enhanced by the consultative expertise of qualified and credentialed company specialists, this should not result in increased audit costs or expanded audit requirements. If audit standards do not allow auditors to accept (after proper testing) the strength of management's estimation process, but encourage auditors to expand audit procedures, it is possible that management will seek to offset the increased audit cost by reducing the strength of the internal control processes, with negative consequences.

Question:

13. **Are there additional economic considerations associated with this proposal that the Board should consider? If so, what are those considerations?**

Response

We believe that when the provisions of the Fair Value Quality Initiative are followed, management will derive and document fair value measurements with greater rigor than in the past. As such, auditors will be able to assess management's fair value process and conclusions more efficiently, enhancing the overall quality of the audit while potentially reducing audit costs. To achieve these economic savings the PCAOB should more directly recognize the Fair Value Quality Initiative and its related benefits within the auditing standards.

Question:

19. **Should the proposed standard limit the auditor's selection of an approach and, if so, under what circumstances?**

    Response

    Yes. When the auditor has tested the company's estimation process used to develop the accounting estimate, and the process is deemed reasonable, the standard should allow the auditor to complete their procedures. The current draft may inadvertently encourage auditors to extend their audit procedures by coming up with their own fair value estimate and evaluating subsequent event information, even when the company's process and results have been deemed to be reasonable. Unnecessarily expanding audit procedures could increase overall costs with little additional benefit. Further, the concept of evaluating subsequent events (using hindsight) may be incongruent with the premise of fair value, which is forward looking.

    Also, please see in *Appendix A* of this letter our suggested edits to par. 07 of the proposed AS 2501.

Question:

20. **Are the proposed requirements for evaluating the company's method used to develop accounting estimates clear? Are there other matters that are important to evaluating a method that should be included in the proposed requirements?**

    Response

    The Estimates Proposal does not appear to give "credit" in the company's process or method of determining fair value for complying with the MPF/DF and using company-employed or company-engaged valuation specialist. The use of an employed and/or engaged specialist can enhance the reliability of management's estimates.

    Additionally, as noted in our response to the companion Specialists Proposal, we have the following comments which are also pertinent considerations in the audit of fair value estimates: we believe that further distinction could be made between company-employed and company-engaged specialists in the risk assessment process, as there is a meaningful difference between the two. In addition to the engaged specialist being a third party - which would presumably affect the reliability of management's assertions supported by such specialist's work from an audit perspective – a company-engaged specialist is specialized and occupied full-time in valuation.

Question:

21. Are there any further requirements regarding testing internal data or evaluating the relevance and reliability of external data that the Board should consider?

Response

With respect to Fair Value Measurements, data and testing of data should reflect market participant assumptions. Management and auditors should ensure that the data being used is consistent with the accounting standard (ASC Topic 820), which requires judgment in assessing certain market participant inputs.

Question:

22. Are the proposed requirements to evaluate whether data was appropriately used by the company clear? Are there other criteria the auditor should assess to make this evaluation? If so, what are they?

Response

With respect to Fair Value Measurements, the requirements could be made more clear if the MPF/DF was complied with. The MPF, for example, dictates the documentation requirements for ensuring that inputs such as prospective financial information are supported. Further, as previously noted, such inputs should reflect market participant assumptions.

Question:

23. Are the proposed requirements for the auditor to identify significant assumptions and to evaluate whether the company has a reasonable basis for significant assumptions used clear? Do those requirements pose any practical difficulties and, if so, how could the proposed standard be revised to address those difficulties?

Response

To be relevant, fair value measurements require the application of informed judgment with respect to market participant assumptions and with respect to inputs used (observable and unobservable). In many cases, the most relevant fair value measurement is derived from unobservable inputs. The audit standard should acknowledge the fact that a reasonable range of fair value requires the application of informed judgment by management and by the auditor.

Question:

24. Are the proposed requirements described above for developing an independent expectation clear? Are there other matters relevant to the proposed requirements that the Board should consider?

Response

The Board should clarify those situations where developing an independent expectation of the estimate would be appropriate. Otherwise there is a risk that auditors will always feel the need to come up with an independent assessment of value, even when management has demonstrated a reliable valuation process and has used a qualified employed or engaged specialist.

Further, there is a risk that auditors could impair their independence when coming up with their own estimate for more than confirmatory evidence.

Question:

25. Is the proposed requirement that the auditor have a reasonable basis for the assumptions and method used when the auditor independently derives assumptions, or uses his or her own method in developing an independent expectation, clear? Are there other matters relevant to the proposed requirement that the Board should consider?

Response

The auditor should have a reasonable basis for the assumptions and methods they use. However, when management has a strong estimation process, following the MPF and utilizing an experienced, knowledgeable, credentialed specialist, there may not be a need for the auditor to develop their own estimate. In situations where they do derive their own estimate of fair value, it should be as a corroborating technique. Otherwise the auditor runs the risk of impairing their independence as previously noted.

Question:

28. Are the proposed requirements for developing an independent expectation when using the company's data, assumptions, or methods clear?

Response

The proposed requirements are clear. What is less clear is whether or not the auditor should be developing their own estimate, and for what purpose. If the auditor has obtained sufficient evidence that management's process and results are reasonable, there may be no need for the auditor to develop their own estimate.

Question:

30. Are there additional factors that the auditor should take into account when evaluating the relevance of the audit evidence obtained from events or transactions occurring after the measurement date?

Response

Yes. The Board may wish to add cautionary language with respect to fair value estimates. Fair value measurements are derived from information that would be known or knowable to a market participant at the measurement date. In some cases, subsequent events, and more importantly subsequent transactions, may not have been known or knowable and therefore should not impact the fair value measurement at the measurement date.

Question:

31. Are there other matters relevant to financial instruments that should be considered or included in Appendix A of the proposed standard?

Response

As previously noted, the standard should encourage the use of the MPF, and the involvement of a CEIV or CVFI credential holder, to enhance the quality of fair value measurements. Further, when management demonstrates that it has a process which generates reasonable fair value estimates, audit standards should not encourage the auditors to expand the nature and extent of their testing. Furthermore, the standard should encourage that the auditor specialist also has the CEIV or CVFI credential.

Question:

33. Are there other sources of pricing information for financial instruments that should be addressed in the proposed standard?

Response

No. The standard should clearly articulate that pricing services or broker quotes must be based on actual, contemporaneous and executed or executable transactions. Otherwise, support for fair value measurements should be derived from a model, often using an employed or engaged valuation specialist with appropriate experience and credentials.

Question:

34. Are the requirements for using information from a pricing service clear? Are there other requirements that should be considered? For example, are there other methods used by pricing services to generate pricing information that are not currently addressed in the proposed standard?

Response

For Pricing Service data to be relevant and reliable, management and the auditor must be in a position to determine that the reported prices are contemporaneous and from orderly transactions reflecting a similar quantity of the financial instrument.

Note: While blockage discounts are prohibited under ASC Topic 820, it should be noted that the price of a single private bond may deviate substantially from the price of 100,000 of the same bond. The unit of account for 100,000 non-actively traded bonds may be 100,000 bonds. A pricing service price for a recent trade of a single bond may not be relevant or reliable for 100,000 bonds.

Additionally, while blockage discounts are not permitted, illiquidity discounts (for a single instrument unit of account) are permitted if market participants would consider them. As a result, it is exceedingly challenging to use, interpret or audit pricing service or broker quotes without fully understanding how such prices and quotes are derived. Prices from actual transactions for a given quantity of financial instruments may invariably reflect the impact of blockage – be it a discount or a premium.

Question:

37. Are there other characteristics affecting the relevance and reliability of evidence provided by a broker quote that the proposed standard should include?

Response

Similar to our response under 34 above, broker quotes should be contemporaneous and actionable. They should represent the price at which the broker is willing to transact, reflecting the transaction quantity. Non-binding indications of possible value do not provide sufficient evidence of fair value for management or for the auditor.

Question:

38. Are there additional factors that the auditor should take into account when evaluating the reasonableness of unobservable inputs?

Response

Unobservable inputs should be congruent with market participant assumptions for the financial instrument being valued. Unobservable inputs in some situations may be more qualitative and in other situations may be quantitative. Of greatest importance in deriving a relevant and reliable fair value measurement is understanding and using appropriate market participant assumptions.

From a risk-based audit perspective, the fact that in some cases unobservable inputs provide the most relevant fair value measurement highlights the need to provide greater emphasis on management's valuation process than on the specific inputs used. When management complies with the requirements of the Fair Value Quality Initiative and as appropriate, utilizes the services of appropriate qualified, credentialed company specialists, management's process can be more effectively assessed by the auditor.

Question:

39. Are the proposed requirements for evaluating audit evidence regarding the valuation of investments based on investee financial condition or operating results clear?

Response

No. Fair value measurements are derived from market participant assumptions. Market participants may not rely on the financial statements of the subject company, or may make adjustments to historical results or projections of the subject company. The Estimates Proposal and amendments to other standards should reflect the need to focus on market participant assumptions, and not on other data that a market participant would <u>not</u> use in coming to their estimate of fair value.

Question:

40. Does the proposed alternative approach for audits of certain investment companies represent a significant change in practice for those audits? If so, how? Is that alternative approach applied in other circumstances? If so, what are those circumstances?

Response

The proposed alternative approach would be more clear if it referenced AICPA TIS 2220 which provides guidance on estimating fair value for a fund interest using NAV. The current wording may be misunderstood, resulting in an audit scope that is arguably either unnecessarily broad, or too narrow.

Question:

41. Are there other matters relevant to understanding the process used to develop accounting estimates that could be included in the risk assessment standard?

Response

Yes. In addition to understanding whether management has used a company-engaged specialist, consideration should be given to the knowledge, experience and credentials of that company-engaged specialist. Further, a qualified, experienced, knowledgeable, credentialed company-engaged specialist would generally enhance management's valuation process and the resultant quality of management's valuation assertions.

Consideration should also be given to whether or not management's valuation process is consistent with the MPF or the DF, as applicable.