July 13, 2022

Public Company Accounting Oversight Board
Office of the Secretary
1666 K Street NW
Washington DC 2006-2803

Via email to: comments@pcaobus.org

Dear Chairwoman Williams:

Thank you for an opportunity to comment on the PCAOB's interim analysis to evaluate the initial impact of new requirements for auditing accounting estimates, including fair value measurements, and using the work of specialists. We respectfully submit our comments for the Board's consideration.

In our review of the Request for Comments document, dated April 12, 2022, we noticed that it ***excluded specialists in the call for comments***. The outline suggested that the PCAOB staff only planned to conduct surveys and targeted interviews of auditors, preparers, and audit committee members. We complement this process by surveying valuation service providers (*specialists*, hereafter). Specialists' perceptions are important to include because they are integral to and help facilitate the successful implementation of the new and revised auditing standards.

We distributed our survey to specialists who prepare and/or evaluate fair value measurements for companies listed in the United States (e.g., SEC registrants). However, these specialists may not have been (and do not necessarily need to be) domiciled in the United States because their work is typically sourced globally (see Barr-Pulliam, Joe, Mason, and Sanderson 2019 here). We included specialists at accounting and valuation consulting firms of all sizes in our survey distribution.

The views expressed in this letter are the aggregated perceptions of our survey participants and do not reflect an official position of their firms or any professional organization with which they may be associated. In addition, the comments reflect the consensus view of the participants, not necessarily the views of every individual member.

We hope our attached comments and suggestions are helpful and will assist your office. If you have any questions about our input, please feel free to contact us for any follow-up.

Respectfully submitted,

Dereck Barr-Pulliam

<u>Contributors</u>:
Dereck Barr-Pulliam, University of Louisville <dereck.barr-pulliam@louisville.edu>
Stephani Mason, DePaul University <smason18@depaul.edu>

We divide this response into three parts. First, we include an overview of the survey participants. Next, we provide a general comment based on our assessment of the responses. Then, we address specific questions posed in the *Request for Comment*s. These comments are based exclusively on responses to our survey. We also provide participants' perceptions of questions not included in but relevant to the *Request for Comments*.

Respondents

Our 30 survey respondents are almost evenly divided between accounting and valuation consulting firms. There are also a few responses from in-house valuation groups employed by SEC Registrants. Nearly all accounting firm respondents are employed by global network firms (GNFs), with an even split between Big Four and non-Big Four. In-house respondents are from investment banks and private equity/venture capital funds. Most of the respondents are based in North America, with a small percentage in the United Kingdom.

Participating specialists are highly qualified to respond as 70% hold postgraduate degrees and report at least one valuation-specific credential such as the ABV or CBV, ASA, CEIV, or CVFI. Twenty percent hold CFA charters, while another 20% hold a CPA or CA license. Respondents have extensive valuation experience as 25 (83%) have more than 10 years of experience. Two-thirds report that they prepare estimates for management, and three-fourths report that they evaluate estimates in conjunction with audit engagement teams. Sixty percent even report prior audit experience, and 20% have more than five years of audit experience.

We asked respondents whether they were familiar with the new PCAOB requirements for Auditing Accounting Estimates and the Auditor's Use of the Work of Specialists, as well as their level of familiarity with the new requirement. More than sixty percent report familiarity with each of the new requirements. Half reported being at least somewhat with each of the new requirements. Overall, these respondents are well suited to provide insights for this comment letter.

General Comment

Specialists that responded provided valuable information we used to formulate this comment letter. Based on their observations, we find that the new PCAOB requirements for auditing accounting estimates, including fair value measurements, and new PCAOB requirements for the auditor's use of the work of specialists had implications for communications generally led to increased (and possibly enhanced) communications between valuation teams and other constituent groups. The additional communication seemed to increase time spent on engagements, which likely resulted in higher fees. However, many additional fees seem to be one-time rather than recurring. Benefits and/or efficiencies did not necessarily offset these costs. While numerous respondents indicated benefits and/or efficiencies for the valuation and audit teams, few believed that benefits and/or efficiencies accrued to management/financial reporting entities. It does not appear that valuation and audit teams encountered significant challenges in implementing the new requirements, but financial reporting entities likely did. There was consensus that the new requirements both contributed to an increase in quality and fees.

Most respondents agreed that the new requirements for the auditor's use of the work of specialists have affected or will affect how companies use specialists in preparing their financial statements and how auditors use specialists in evaluating financial statements. Some key points are that audit teams are more likely to need their own specialist assistance to comply with the new requirements and are less likely to rely on the work of management's specialists. Most respondents believe that the demand for specialists is outpacing the supply of specialists, creating a shortage in the pool of *qualified* specialists.

The new requirements did not seem to create any adverse, unintended consequences. In addition, there did not seem to be any major audit issues that the respondents suggested paying attention to, other than the often-cited issue of fraud. Below are the responses to the questions we posed in our survey based on the Request for Comments published by the PCAOB.

Responses to Specific Questions

Auditing Accounting Estimates, Including Fair Value Measurements

- The new PCAOB requirements for auditing accounting estimates, including fair value measurements, had (or will have) implications for communications between my valuation team and (1) *the audit team when we assisted on audit engagements*, (2) *the client's valuation team when we assisted on audit engagements*, (3) *the client when we prepared estimates on behalf of management*, and (4) *the client's auditor when we prepared estimates on behalf of management*.

  The consensus among respondents was that the new PCAOB requirements for auditing accounting estimates had implications for valuation specialists' communications. When evaluating the reasonableness of estimates (*evaluation role*) as part of an audit team, nearly all agreed that it impacted communications with the audit team, and more than half agreed that there were implications for communications with the audit engagement client's valuation team. They noted similar communication implications when preparing estimates for management (*preparation role*). Eighty percent agreed that there were implications for communicating with the client's auditor when they prepare estimates for management. These changes include the nature, extent, and documentation of communication among specialists and auditors, management, and other specialists.

  Illustrative comments provided in open-ended responses that both support and suggest no changes in communication include [*emphasis added*]:

  Nature and Extent
  - The new standards increase the responsibility, and this usually comes with *increased time and communication*.
  - The new standards enhance the requirement for auditors to apply professional skepticism to valuation specialists on their own audit team. This will likely *enhance the communication from those individuals with management's outside specialists*.
  - I don't think it will change the interaction as a client too much with auditors but *adds to the process anytime we engage a specialist*.
  - *Increased communication/transparency/diligence is primary basis for the new standards*.
  - We believe our existing work is consistent with the new requirements, and thus this *should cause* ***little or no impact****.*

  Documentation
  - The new requirements were largely aligned with our current practices but *changed the way that we document our communications*.
  - **Our processes have been well established for some time, and there aren't many changes to those processes**. *We have some new templates in place to document the results of our work as a result of increasing PCAOB scrutiny and the new standards, but those are also largely consistent with what we had 5 years ago*.
  - *Increased correspondence will be required due to the subjectivity of estimates. This correspondence will likely result in additional color/detail regarding inputs and assumptions*.

- The new PCAOB requirements for auditing accounting estimates, including fair value measurements, imposed costs for (1) *my valuation team*, (2) *audit teams*, and (3) *management/financial reporting entities* to implement the new requirements.

Overwhelmingly respondents agreed that the new requirements imposed costs to implement. Two-thirds agreed that costs were imposed on valuation teams, while eighty percent agreed that costs were imposed on audit teams, and more than sixty percent agreed that the requirements imposed costs on management/preparers to implement the new requirements. The consistently noted cost relates to time on the part of all stakeholders.

Illustrative comments provided in open-ended responses include [*emphasis added*]:

Combined

- Will require more time of *all stakeholders in the process*; valuation firm fees did not increase—audit firms sampled less/tested more completely.
- The level of documentation for the *valuation specialist will remain unchanged*. However, there are *additional burdens on the core audit team to improve documentation of the coordination of experts*. This will be a recurring cost but will take a little bit more time the first year as teams adjust to the new standard and get templates in place. *I have not seen any burden put on clients*.
- Additional hours, *increase recurring (5-10% of total fees)*

Valuation Team

- The new standards increase the responsibility, and this usually comes with *increased time and communication*.
- I can't estimate the costs for our firm, but *one-time costs would include creating new processes, training and implementation and monitoring*.
- Increased questioning should *increase the requirements for valuation specialists at audit firms and the time and implicit hourly costs incurred by clients*.
- As an outside specialist, I am anticipating an *increase in the amount of time spent with clients' outside audit teams*.
- ***I believe we have been meeting the requirements, so no new costs are required.***

Audit Engagement Team

- The biggest change was the requirement that the *auditor's specialist has to certify tools and document a detailed review of the models we use in our comparative calculations* – so now companies have to get their own valuation, and we have to check it, and then we have to check our checks.
- One-time – hiring a specialist to review policy and procedures comply. Recurring – additional resources and time associated with meeting the guidelines
- Incremental costs were primarily associated with *updating audit documentation*.
- If the valuation is recurring, the cost is recurring. *It takes more time to audit and document to meet the standards from the PCAOB.*

* The new PCAOB requirements for auditing accounting estimates, including fair value measurements, generated some benefits and/or efficiencies for (1) *my valuation team*, (2) *audit teams*, and (3) *management/financial reporting entities* from implementing the new requirements.

  Respondents had a mixed reaction to the benefits and/or efficiencies. Just over half of the respondents (sixty percent) agreed that there were benefits and/or efficiencies for the valuation teams (audit teams) from implementing the new requirements. However, only forty percent agreed that there were benefits and/or efficiencies for management/financial reporting entities. In fact, over 10% strongly disagreed that there were benefits and/or efficiencies for management/financial reporting entities.

  Illustrative comments provided in open-ended responses include [*emphasis added*]:

Benefits and/or Efficiencies

- There were *no efficiencies gained*. Benefits may be that there is *more accuracy in the valuations*.
- The *improved need for communication up front* will likely have some benefits in avoiding unplanned communication late in the audit.
- …the benefits directly relate to the *ability* [of specialists] *to increase billings*
- …*much less risks in conclusions and less risk of misstatements*.
- …*more work for specialists with higher skill set and capacity* to incur increased risk and liability.
- Increased clarity about testing audit estimates and how the PCAOB / SEC views this process may lead to less uncertainty in terms of the approach to testing.
- Improved transparency
- …clarity around *expectations and risk-based approach.*

Neither

- None. *Regulatory burden only*
- …this is not changing the substance of what we do, *just imposing more documentation related burdens*.
- *...More work done by auditors*, much of it not focused on real risk and cost-benefit.
- …*More risk management/scrutiny*.

- The new PCAOB requirements for auditing accounting estimates, including fair value measurements, created significant challenges for (1) *my valuation team*, (2) *audit teams*, and (3) *management/financial reporting entities* to implement the new requirements.

  Forty percent of respondents disagreed that the new requirements created significant challenges for valuation teams, whereas one-third agreed. There was an even split between respondents who agreed and disagreed on whether the new requirements created significant challenges for audit teams. Half of the respondents agreed that the new requirements created significant challenges for management/financial reporting entities to implement the new requirements. Only a quarter disagreed, and the remainder neither agreed nor disagreed.

  Illustrative comments provided in open-ended responses include [*emphasis added*]:

  - Will be a *challenge for management depending on how robust their accounting/finance/financial reporting group is*. If this falls in the lap of the CFO, it will be a strain on resources.
  - The PCAOB wrote a very light standard – it *looks like the requirements are less than ISA 540*. But then *their [PCAOB] interpretation and the things that they are requiring behind the scenes has been quite onerous*.
  - Professional *time costs money but saves money in the end* reporting of fair value for companies verging on bankruptcy.
  - …*increased risk and liability and enhanced research and communication*.
  - I believe the *required level of documentation of assumptions will likely increase*.
  - Gathering the correct information to make the proper assessments. *We expect to find the reporting entities that we deal with to not be set up to gather what we need*.
  - No significant challenges yet but *expect the PCAOB to use these standards against auditors when the time comes*.

- The new PCAOB requirements for auditing accounting estimates, including fair value measurements, have contributed to an increase in (1) *financial reporting quality*, (2) *audit quality*, (3) *preparation valuation fees*, (4) *audit assist valuation fees*, (5) and *audit fees*.

  There was consensus that the new requirements both contributed to an increase in quality and fees. More than three-fourths agreed that there was (or will be) an increase in financial reporting quality, and almost seventy percent agreed that there was (or will be) an increase in audit quality. Two-thirds of the respondents agreed that the new requirements did (or will) contribute to an increase in valuation fees for the preparation of estimates for financial reporting. Of those that perform audit assist services, over sixty percent agreed that the new requirements did (or will) contribute to an increase in valuation fees. Of those with knowledge of audit fees, eighty percent agreed that the new requirements contributed (or will contribute) to an increase in fees.

  No open-ended responses differed from the other responses above.

Auditor's Use of the Work of Specialists

- The new PCAOB requirements for the auditor's use of the work of specialists had implications for communications between my valuation team and (1) *the audit team when we assisted on audit engagements*, (2) *the client's valuation team when we assisted on audit engagements*, (3) *the client when we prepared estimates on behalf of management*, and (4) *the client's auditor when we prepared estimates on behalf of management*.

  As with the new requirements for auditing accounting estimates, respondents largely agreed that the new requirements for the auditor's use of the work of specialists had implications for valuation specialists' communications. Over eighty percent agreed that it impacted communications with the audit team during audit assist engagements, and more than sixty percent agreed that there were implications for communications with the client's valuation team when evaluating estimates during audit assist engagements or with the client when preparing estimates for management. Almost three-fourths agreed that there were implications for communicating with the client's auditor when preparing estimates for management.

  Illustrative comments provided in open-ended responses that both support and suggest **no changes** in communication include [*emphasis added*]:

  - *Will probably lead to more communications to make sure everyone is on the same page*.
  - There are *some small enhanced communications between the audit valuation specialist and the audit team*. However, **I see no impact in the communication outside of that dynamic**.
  - The requirements were largely in place before the recent changes, and from a valuation specialist perspective, what we do didn't change. *Some documentation requirements changed, but nothing about the process of performing the valuation / valuation review changed*.
  - The new standards *put more emphasis on the judgment of the auditor and not simply accepting the opinion of his internal valuation team*.
  - The *greater work and understanding required for compliance should mean that communication will increase*….
  - Specialists may not have been required in previous engagements, and thus *any communication greater than none is an increase in communication.*
  - …*significantly more billable time* will be required.
  - *Sets a standard that top specialists will rely on*.
  - *Questions and answers do not create a conflict of interest, rather a cooperative environment for gaining a sound perspective of asset fair value*.
  - increased risk and liability resulting in increased time required
  - Audit teams and their valuation specialists are *doing more work* which naturally increases the work of management and management's valuation specialists.

- The new PCAOB requirements for the auditor's use of the work of specialists imposed costs for (1) *my valuation team*, (2) *audit teams*, and (3) *management/financial reporting entities* to implement the new requirements.

  Respondents mainly agreed that the new PCAOB requirements for the auditor's use of the work of specialists-imposed costs for the various constituents to the fair value financial reporting process. Two-thirds agreed that it imposed costs on valuation teams, more than seventy percent imposed costs on audit teams, and almost two-thirds agreed that it imposed costs on management/financial reporting entities. However, a recurring theme in comments (see below) suggests that the onus is now on auditors and management (financial statement preparers) to increase their involvement in the valuation process.

Illustrative comments provided in open-ended responses include [*emphasis added*]:

Combined

- *Auditors will likely need to adapt their audit programs and work paper templates, and management will likely need to more explicitly take ownership and review the work of the specialists. However, the valuation firm's reports will not likely change much*.
- Will require *additional time for all stakeholders, especially Mandatory Performance Framework guidelines*.
- *Management has to pay either in more fees or more time*.

Valuation Team

- …the *one-time costs pertain to learning curve matters*…the *recurring costs relate to the additional work requirements*.
- *Higher recurring costs due to more time spent* by valuation professionals
- *Cost will increase* depending on the amount of deeply difficult data gathering. That depends upon the quality of data maintained by management on assets, use, operating costs, maintenance, and obsolescence issues….

Audit Engagement Team

- *…recurring costs increase due to expanded scope and myopic approach to valuation by the audit firm and the audit firm specialists*.
- …n/a **no change to the valuation side processes**…*likely some checklist updates on the audit side*.
- *…many audit firms switched from sampling to more complete testing.*
- I expect *more time to be spent with reviews by audit teams*.

* The new PCAOB requirements for the auditor's use of the work of specialists generated some benefits and/or efficiencies for (1) *my valuation team*, (2) *audit teams*, and (3) *management/financial reporting entities* from implementing the new requirements.

  In contrast to the responses on the costs imposed by the new requirements, slightly more than half agreed that the new requirements generated some benefits and/or efficiencies for valuation teams and audit teams from implementing the new requirements. For management/financial reporting entities, there was an even split between those that agreed and disagreed that the new requirements generated some benefits and/or efficiencies.

  Illustrative comments in open-ended responses include [*emphasis added*]:

  - Will *require use of specialists where they weren't required before*.
  - *Rather than focusing on management's internal controls and valuation processes, the auditor generally decides to reperform their own valuation analysis, increasing cost and perversely resulting in a lack of independence as management must adopt the auditor estimate to avoid a difference with the auditor.*
  - **No efficiencies**
  - *Impact in both directions*. *Hopefully, enhanced quality at increased cost*.
  - If there is *more clarity in what the appropriate testing of audit estimates looks like, the audit review process is expected to be more streamlined*.
  - **Feels like an additional regulatory hurdle, do not see ability to add efficiencies**
  - **enhanced clarity around risk-based approach.**
  - *…all such benefits* (one-time and recurring) *will emanate from the ability to charge more* [valuation] *fees*.

- The new PCAOB requirements for the auditor's use of the work of specialists created significant challenges for (1) *my valuation team*, (2) *audit teams*, and (3) *management/financial reporting entities* to implement the new requirements.

  Less than half of the respondents agreed that the new requirements created significant challenges for valuation teams, audit teams, or management/financial reporting entities.

  Illustrative comments in open-ended responses that support the points above include [*emphasis added*]:

  - *The PCAOB wrote a fairly light standard -- it looks simpler than ISA 540, but their interpretation of the requirements* (e.g., documenting the reliability of data used) *has been quite onerous*.
  - *That all depends upon the attitude of the participants and the quality of specialists' work.*
  - *If a specialist isn't transparent, they shouldn't be used*.
  - *…more detailed scope of work and analysis will be required.*
  - *Largely will be status quo in terms of the process*.
  - *In my experience we do not see wholesale changes - especially in the asset management and financial services industry,* which is my area of focus.
  - Feels like *it will primarily impact the audit team and less so the client.*

- The new PCAOB requirements for the auditor's use of the work of specialists have contributed to an increase in (1) *financial reporting quality*, (2) *audit quality*, (3) *preparation valuation fees,* (4) *audit assist valuation fees*, (5) and *audit fees*.

  Like the responses for the new requirements for auditing accounting estimates, including fair value measurements, respondents agreed that the new requirements for the auditor's use of the work of specialists have contributed (will contribute) to an increase in quality and fees. Two-thirds agreed that there was (or will be) an increase in financial reporting and audit quality, including several that strongly agree. More than half of the respondents agreed that the new requirements did (or will) contribute to an increase in valuation fees for the preparation of estimates for financial reporting in valuation fees for audit assist engagements. Of those with knowledge of audit fees, the majority agreed that the new requirements contributed (or will contribute) to an increase in fees.

  No open-ended responses differed from responses from Auditing Accounting Estimates, Including Fair Value Measurements.

- The new PCAOB requirements for the auditor's use of the work of specialists have affected how (1) *companies use specialists in preparing their financial statements* and (2) *auditors use specialists in evaluating financial statements*.

  Almost seventy-five percent of respondents agreed that the new requirements for the auditor's use of the work of specialists have affected how companies use specialists in preparing their financial statements and auditors use specialists in evaluating financial statements. For both, numerous respondents strongly agreed.

  Illustrative comments in open-ended responses include [*emphasis added*]:

Clarity Around Ownership of the Reported Values

- The *role of specialist is more clearly defined* as well as the fact that *management has to take ownership of the valuation* and the *audit firm should have a robust process for testing valuations*.

Nature, Extent, and Timing of Involvement in Preparation/Evaluation of Estimates

- …the *degree* [extent] *of work required to be performed will increase.*
- *More potential valuation involvement* for non-audit clients.
- **I don't expect any changes in clients' hiring of specialists**.
- *…clarity around need for experience, pre-planning, due diligence, transparency*
- *Certain of the requirements are harder for audit teams to meet without specialist assistance*.
- *Auditors are less likely to rely on the work of management's specialists*. *Auditors seem to have interpreted the new standards as a way for them to increase fees by reperforming what management already did or had done by their specialists, rather than testing what management and their specialists did*.

- As a result of the new PCAOB requirements for the auditor's use of the work of specialists, I have encountered shortages in the pool of qualified specialists.

  Nearly half of the respondents agreed on some level. When we asked what factors they believe have contributed to such shortages, we found a variety of responses, but most attribute the shortage to reasons other than the impact of the new PCAOB requirements. The most frequently cited responses point to the demand for specialists' services far outpacing the availability of the supply of competent specialist talent, corroborating findings in Barr-Pulliam, Joe, Sanderson, and Mason (2021) and Barr-Pulliam, Sanderson, and Mason (2022).

  Illustrative comments include [*emphasis added*]:

  - We are a small firm which makes it *difficult to attract talent*
  - Shortages exist because of the *overall market growth in the need for valuation specialists. It is difficult, if not impossible, to tie it to the PCAOB rules.*
  - *Impact of Covid on in-person training*.
  - *High demand* – recruiting has been very challenging.
  - *General shortages in all professional services*, not just in the valuation profession
  - Demand for specialists in M&E, business valuation, and real estate assets has *increased, reducing the timely availability of specialists at a higher cost for the highest fee available*.

- We also asked if the two new requirements gave rise to unintended consequences and whether the new requirements diverted auditor attention from other important audit tasks that warrant greater attention. The vast majority neither agreed nor disagreed. However, when we asked them to describe any unintended consequences and any other important audit tasks that warrant greater auditor attention, respondents provided the following comments:

  Please describe any unintended consequences and, if applicable, reference the specific requirements that caused them.

  - Worse client / specialist relationship
  - Increased risk and liability resulting in demand for deep pockets
  - I think the PCAOB interpretation is leading to consequences. *I think incentives are off*
  - *Auditors are violating independence standards by forcing the audit firm's valuation estimates on their audit clients to avoid an audit difference*

Please describe any other important audit tasks that warrant greater auditor attention.

- Working capital
- The *auditor has become lost in the details rather than focusing on big picture valuation risks and conclusions*.
- …*more attention to more details leads to higher fees*.
- I do not believe this effort is too much work and does not divert attention. *Protecting investors in a rising interest rate environment should be paramount*.
- *Fraud issues are likely more important.*
- …fraud detection and prevention.

- Lastly, we asked to what extent any additional fees they reported were due to either of the new requirements versus other contemporaneous environmental factors (e.g., new accounting requirements or COVID-19 pandemic) that may have influenced audit effort.

Illustrative comments in open-ended responses related to audit fees include [*emphasis added*]:

- The only fee increase we experienced was a *shift from sampling to testing complete portfolios. That said, data costs have risen, and experienced employees are harder to maintain. Some of the larger audit firms would benefit from sharing costs by outsourcing to qualified specialists*.
- *The increase may be due to other factors*—for example, as asset managers grow, they are more likely to have institutional investors that request more disclosure about valuation policies and procedures.
- I am not an auditor, but the *new standards require implementation effort and training, and these costs should be passed on*.
- *Fees increase for valuation minimal to fees being imposed due to the overall shortage of auditors*.
- Difficult to parse fully, but there *is more valuation work being performed by auditors and auditor specialists with respect to valuation naturally leading to an increase in fees for such effort.*
- Both *environmental factors leading to shortages of trained auditors and valuation specialists* as well as *requirement for increase in professional skepticism by auditors impact audit fees*.
- …additional *time incurred to comply with the new standards*.