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CERTIFIED PUBLIC ACCOUNTANTS

November 3, 2014

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

RE: PCAOB Staff Consultation Paper, *Auditing Accounting Estimates and Fair Value Measurements*

Board Members:

Thank you for the opportunity to comment upon the PCAOB's Staff Consultation Paper, *Auditing Accounting Estimates and Fair Value Measurements.* We appreciate all the time and effort associated with the research, survey, compilation and solicitation for comment on this very important auditing topic.

As a firm that primarily focuses on auditing registered investment companies, auditing fair value measurements is of the utmost importance to us. Therefore we will focus our comments here to matters pertaining to fair value measurements. That said, we do see merit in a single standard that addresses both accounting estimates and fair value measurements, as there is significant conceptual overlap between the two. We believe that among the alternatives that the Staff Consultation Paper details, the issuance of a new separate standard on auditing accounting estimates and fair value measurements would be preferable in that a new standard would afford the best opportunity to provide comprehensive current relevant guidance to audit firms. The other alternatives put forth would result in somewhat of a patchwork to existing standards. Our responses to selected questions outlined in the Consultation Paper are detailed below.

Question 9. Are there considerations relevant to auditing accounting estimates and fair value measurements including other regulatory requirements specific to certain industries that the staff should take into account?

We would ask that any new standard on fair value measurements reflect the spirit of the SEC's Codification of Financial Reporting Policies Section 404.03. Accounting, Valuation and Disclosure of Investment Securities, Accounting Series Release No. 118, which states, in relevant part; "*Auditing security valuations…In the case of securities carried at "fair value" as determined by the Board of Directors in "good faith," the accountant does not function as an appraiser and is not* *expected to substitute his judgment for that of the company's directors; rather, he should review all information considered by the board or by analysts reporting to it, read relevant minutes of directors' meetings, and ascertain the procedures followed by the directors.*" As stated on page 19 of the Consultation Paper, "…*the objective of the auditor under a potential new standard would be to obtain sufficient appropriate audit evidence to determine whether accounting estimates are reasonable and in conformity with the applicable financial reporting framework.*" We believe that this objective is consistent with the SEC's message in its Codification of Financial Reporting Policies Section 404.03 and that the fact that the auditor is not expected to serve as an appraiser or substitute his or her judgment for that of its client is an important principle that should be emphasized in any potential new standard on this topic.

Question 23. Aside from testing management's process, developing an independent estimate, or reviewing subsequent events and transactions as further discussed, should a potential new standard allow for or require other approaches to testing accounting estimates? If so, what other approaches would be appropriate?

We believe that the three approaches for substantively testing fair value measurements contained in AU sec. 328 and AU sec. 342 of the current standards are time tested, appropriate and should form the foundation for any auditor's approach to substantively testing fair value measurements. However, no standard can anticipate every potential scenario that an auditor may encounter. We believe that any new standard should not serve to erode auditor judgment and allow for, but not require, alternative approaches to testing accounting estimates and fair value measurements. While examples of alternative approaches may be helpful, we believe the overarching principal with respect to alternative approaches should be to allow an auditor to tailor his substantive testing as he or she deems necessary under the circumstances, so long as the auditor achieves the objective of obtaining sufficient appropriate audit evidence to determine whether accounting estimates are reasonable and in conformity with the applicable financial reporting framework.

Question 20. Given the existing requirements related to testing controls in Auditing Standard No. 13 (and Auditing Standard No. 5, as applicable), would specific requirements on testing internal controls over accounting estimates be useful (e.g., evaluation of design and operating effectiveness of key review controls over accounting estimates)?

Question 25. Are there enhancements to the existing requirements for testing data used by management to develop the accounting estimate the staff should consider?

We have chosen to respond to Question 20 in conjunction with Question 25 for the following reason. Page 28 of the Consultation Paper discusses how existing standards (AS 12) require an auditor to obtain an understanding of internal control sufficient to plan the audit. It further discusses how existing standards (AS 13) require the auditor to obtain evidence that the controls selected for testing were designed and operated effectively. The Consultation Paper also states that these requirements can be readily applied to tests of controls over accounting estimates and that the Staff is considering whether additional requirements related to testing controls over accounting estimates are necessary. With respect to this, the Consultation Paper poses question number 20, above. In several places, the Consultation Paper addresses the testing of management's processes used in developing accounting estimates and fair value measurements – in particular on pages 13, 20 and 30 – 31. On page 31, the Consultation Paper states that a "potential new standard could build on the requirements in the existing standards for testing the company's process including: (i) evaluating the appropriateness of the company's methods; (ii) testing the data used; and (iii) evaluating the reasonableness of significant assumptions." The paper goes on to discuss in great detail the concepts of evaluating the appropriateness of the company's methods and evaluating the reasonableness of significant assumptions but does not seem to further address testing data used. On page 13, the Consultation Paper speaks about existing standards and how testing "the data used" involves evaluating whether the data is complete, accurate, relevant and consistent. We think that evaluating the data and the process surrounding its use may be accomplished by testing controls. Clearly page 28 of the Consultation Paper contemplates some use of control testing in the evaluation of management's process for developing accounting estimates and fair value measurements. We believe that some linkage between the evaluation of management's processes and testing controls would be helpful. In particular, guidance on when and how an auditor might consider testing controls surrounding management's process of developing accounting estimates and fair value measurements and when those tests could be utilized in a "dual purpose" manner with the substantive objective of evaluating management's process would be very helpful.

Question 26. Are the potential requirements described above for evaluating whether the company's method used to develop accounting estimates appropriate for both accounting estimates and fair value measurements?

This question relates to potential proposed standard requirements detailed on page 33 of the Consultation Paper that would call for an auditor to consider certain factors when evaluating the appropriateness of a company's methods used to develop an accounting estimate or fair value measurement. Those factors, as cited on page 33, are whether the method is a) accepted in the company's industry, b) applied consistently (including whether consistency is an appropriate concern when the company's environment or circumstances change), c) reasons for changes in methods and d) in circumstances where multiple methods result in significantly different estimates, the reasons management selected the method it is utilizing. We believe that guidance as to how an auditor should approach evaluating the overall appropriateness of a company's method for developing accounting estimates and fair value estimates would be helpful. Furthermore, we believe that standard industry practices and consistency are important factors that an auditor should consider in making such evaluations. We further, believe that the standard should make it clear that evaluations of the appropriateness of such management methods should not be limited to these factors, leaving room for the auditor to exercise judgment in making such evaluations.

Question 28. Would a requirement for the auditor to determine which assumptions used by management are significant assumptions present difficulties in practice? Should the staff consider a requirement for the auditor to identify assumptions not used by management, which might be important to the recognition or measurement of the accounting estimate?

We do not believe that a requirement for the auditor to determine which assumptions used by management are significant assumptions would cause difficulties in practice. Such a requirement would not be significantly different to current standards and practice. We have concerns regarding whether the Staff should consider a requirement for the auditor to identify assumptions not used by management, which might be important to the recognition or measurement of the accounting estimate. Perhaps it would be more appropriate for the audit to *consider* whether assumptions not used by management exist and if they do exist, to judge their significance. That said, we believe that any such requirement should be accompanied by guidance as to how the auditor should evaluate the existence of such assumptions that have not been used by management in its process. This would include whether a presumption of a control deficiency exits due to the failure to identify such assumptions, whether such failure can be overcome by the presence of other factors and whether the failure on the part of management to identify and use a significant factor necessarily means that a material misstatement exists (i.e. could management's failure to identify and use a significant assumption in its process nevertheless result in a circumstance where that process produces an accounting estimate or fair value measurement that is not materially misstated).

Question 29. Is the potential requirement suggested above clear and appropriate for both accounting estimates and fair value measurements? Are there other specific characteristics of significant assumptions that should be included?

We believe that including guidance in a new standard as to what assumptions constitute "significant assumptions" would be helpful to auditors. In particular in the box on page 35 of the Consultation Paper, items that a) cause a significant change in the accounting estimate, based on a minor variation in the assumption; b) are susceptible to manipulation or bias; c) are based on unobservable data; and d) are based on observable data adjusted by the company seem of particular importance. Item a, would seem to lend itself to sensitivity based testing (*see response to Question 30, below)*.

Question 30. Are the suggested factors described above appropriate for evaluating the reasonableness of significant assumptions? Are there other factors the auditor should assess when evaluating the reasonableness of significant assumptions relevant to accounting estimates?

We believe that the factors listed in the box at the top of page 37 of the Consultation Paper are helpful in evaluating the reasonableness of significant assumptions. They are, however, somewhat general. We believe that auditors could benefit from having a new standard that provides more specific guidance regarding the reasonableness of significant assumptions. For example, as mentioned above, one of the factors that might lead an auditor to judge an assumption used in developing an accounting estimate or a fair value measurement to be significant might include the sensitivity of the estimate to minor variations in the assumption. When encountering such assumptions, an auditor might find that conducting a sensitivity analysis would be helpful in gauging the reasonableness of an assumption. We think that a new standard on evaluating significant estimates should include guidance on when and how a sensitivity analysis of significant assumptions may be appropriate as well as how auditors might use such analysis in making evaluations of the reasonableness of such assumptions. We do believe that auditor judgment should be preserved and that any new standard should not require a sensitivity analysis, but rather offer guidance as to when and how it may be useful. Additionally, we believe it would be useful for any new standard to include guidance as to what steps an auditor should take or consider when management bias or manipulation of assumptions is suspected. Finally, guidance as to what constitutes a reasonable range of potential significant assumptions would be helpful, particularly given the measurement uncertainty that is present with making fair value measurements on many types of investment assets.

Question 31. Is the potential requirement described above appropriate for all types of accounting estimates? Are there other considerations that should be taken into account in applying this requirement to accounting estimates?

We agree with the concept that when a company uses a specialist employed or engaged by the company to develop an accounting estimate, the auditor should test the information provided by the specialist as if it were produced by the company. Another consideration that a new standard might include would be a requirement for the auditor to assess the qualifications of the specialist. Furthermore, in cases where the client develops a complex accounting estimate or fair value measurement *without* engaging a specialist, it may be appropriate for the auditor to assess whether or not the client has adequate expertise in house to make the estimate or fair value measurement, and, if the auditor concludes that the client does not have adequate expertise in house, what steps the auditor should take in assessing the situation for a possible control deficiency.

Question 32. Are the potential requirements described above for developing an independent estimate, including the potential requirements regarding testing data and assumptions, clear and appropriate for both accounting estimates and fair value measurements? Would these requirements present challenges for certain types of accounting estimates and fair value measurements?

We believe the potential requirements would present at least two specific challenges for fair value measurements determined by a third-party pricing source. First, regarding the ability to obtain and test security specific data, third-party pricing services may not be willing to provide absolute transparency on each and every price they provide, in as doing so would disclose their proprietary models. Second, for an audit of an investment portfolio containing hundreds or thousands of individual security positions, it may be impractical, inefficient or even impossible for an auditor to test the inputs used for each and every price provided by the source. In view of this, guidance on when and how an auditor might use sampling in testing data and assumptions used by third-party pricing sources would be helpful.

Question 35. Are there other matters relevant to developing a range that a potential new standard could address (e.g., requiring a sensitivity analysis)?

Similar to our response to question 30 above, we believe that any new standard addressing situations where an auditor chooses to develop an independent estimate as a range of estimates should include guidance on when and how a sensitivity analysis of significant assumptions may be appropriate in developing and evaluating such a range of estimates. Furthermore, guidance as to what constitutes a reasonable range of potential estimates would be helpful, particularly given the measurement uncertainty that is present with making fair value measurements on many types of investment assets. Again, we believe that auditor judgment should be preserved and that any new standard should not require a sensitivity analysis, only offer guidance as to when and how it may be useful.

Question 39. Should the potential new standard require the auditor to use a third party that is different from the third party used by management? Would such a requirement present challenges for certain types of accounting estimates and fair value measurements?

We do not believe that a potential new standard should *require* the auditor to use a third party that is different from the third party used by management. To do so would erode auditor judgment and ignore the fact that there may be circumstances where it is appropriate for the auditor to use the same third party that is used by management. That being said, we believe that such circumstances should not be the norm. Rather, we think that a presumption that the auditor should utilize a third party that is different from the third party used by management should be included in the standard. In order to overcome this presumption the auditor would be required to document his or her reasons for doing so.

Question 40. Would the factors noted above help the auditor in evaluating the reliability and relevance of evidence obtained from third-party pricing sources? Are there other factors that are applicable in determining the reliability or relevance of evidence obtained from third-party pricing sources?

We believe that the factors listed on pages 45 and 46 of the consultation paper are relevant to an auditor's determination relative to the reliability of evidence provided by a third-party pricing source as well as the relevance of evidence obtained from third-party pricing sources. We believe that any new standard addressing this topic should address means by which auditors can consider the methods used by third-party sources in view of the fact that such third-party sources may not be willing to provide absolute transparency on each and every price they provide. Furthermore, for an audit of an investment portfolio containing hundreds or thousands of individual security positions, it may be impractical, inefficient or even impossible for an auditor to obtain complete transparency from a third-party pricing source on the inputs used for each and every price provided by the source. We believe that a new standard should make it clear that auditors be required to gain an understanding of the methods and inputs that third-party pricing sources use to price categories of securities (i.e. U.S. Treasury securities, municipal bonds, high yield corporate bonds, term loans, mortgage backed and asset backed securities, etc.).

Question 41. Are there other approaches to testing evidence obtained from third-party pricing sources that the staff should consider?

One additional approach to testing the evidence obtained from third-party pricing sources can be gleaned from a common practice in the investment company industry; the utilization of look-back testing. Look-back testing involves a retrospective review whereby the third-party provided prices are compared to actual historical trades occurring within a close proximity to the provided prices to test the reliability of the provided prices, the theory being that the provided prices should only deviate by a reasonable percentage from the actual trades. We believe that any potential standard might discuss how an auditor might utilize look-back testing in evaluating the reliability of third-party prices obtained by an audit client or utilize the look-back testing conducted by the client itself in the audit process.

Question 42. How could a potential new standard differentiate between a third-party pricing source and a specialist?

We believe that a potential new standard should differentiate between a third-party pricing source and a specialist. We believe that the distinction should hinge on the nature of services provided by the third party. For example, third-party pricing services provide prices that are generally available to anyone who subscribes to their service. They typically provide prices electronically on a real-time basis to their subscribers and typically provide pricing coverage for a large volume and broad range of securities. Specialists, on the other hand, are typically engaged for more targeted purposes by auditors and others looking to verify or establish a fair value for more difficult to value investments. We believe that any potential new standard should acknowledge the different roles that third-party pricing sources and specialists fill in the audit process and provide guidance on how auditors should approach working with both.

We would like to thank the Board for the opportunity to comment on the contents of the Staff Consultation Paper, Auditing Accounting Estimates and Fair Value Measurements, and we appreciate the work and effort of the Board to protect investors and further the public interest in the preparation of informative, accurate and independent audit reports.

Sincerely,

BBD, LLP

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